

96-RR

CFTC REGULATORY AUTHORITY REVIEW

HEARINGS
BEFORE THE
SUBCOMMITTEE ON
CONSERVATION AND CREDIT
OF THE
COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES
NINETY-SIXTH CONGRESS
SECOND SESSION

FEBRUARY 12, MAY 21, 22, AND 29, 1980

Serial No. 96-RR

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CFTC REGULATORY AUTHORITY REVIEW

TUESDAY, FEBRUARY 12, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSERVATION AND CREDIT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Harkin, Huckaby, Glickman, Hance, Richmond, Baldus, Bedell, English, Daschle, Madigan, Coleman, and Hopkins.

Staff present: Robert M. Bor, chief counsel; Peggy L. Pecore, clerk; Robert A. Cashdollar and Wayne A. Fletcher.

OPENING REMARKS OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will come to order.

We are delighted that we have as many people in the room as we do today and I want to welcome all of you for this series of hearings.

Today the subcommittee is beginning a series of hearings on the futures markets and the operation of the Commodity Futures Trading Commission. Today, we will hear only Government witnesses. A hearing will be scheduled later to hear the concerns of public witnesses.

One added benefit of this meeting is that it is our first get-together with the new chairman of the CFTC, Chairman James Stone. Chairman Stone brings a distinguished record of past accomplishments, but I can assure him that his present position will challenge all his talents and resources. On the other hand, I want him to know that this committee will try to cooperate in every way possible. Our objective is for the CFTC to carefully and successfully fulfill its mandate.

This committee developed the legislation which created the CFTC back in 1974 and then gave the Commission 4 years to get its house in order. When we began reauthorization in 1978, it was apparent that closer congressional oversight was needed. In the past few weeks a number of subcommittee members have asked for the opportunity to hear the CFTC on a variety of subjects and topics.

In recent months the markets have reached some unprecedented heights. In silver we have seen the exchanges take stiff self-regulatory actions. The Soviet embargo resulted in a 2-day suspension of

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trading. New and innovative contracts have been submitted to the Commission for approval. All of these matters and more are of interest to me and the members of this subcommittee.

At this point I want to say to you, Commissioner Stone and others, that we are delighted you are here.

Before we hear from you, I want to recognize Mr. Glickman for a statement.

OPENING REMARKS OF HON. DAN GLICKMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. GLICKMAN. Thank you, Mr. Chairman. I would like to thank the chairman of the subcommittee for calling these hearings.

I have had some significant interest in the operation of the CFTC, primarily because I have worked myself as an attorney for the Securities and Exchange Commission before I came to Congress.

As the chairman mentioned, the CFTC is working under a 4-year sunset which, as you know, expires in September 1982. In fact, you are the first Federal agency that has been effectively sunsetted on a continuous basis, and I think that that is a positive thing. It means that this subcommittee is going to be exercising extraordinarily close scrutiny over your jurisdiction including the actions you have taken to protect farmers and those you take, to the extent you can, to maintain an orderly market. It will review the actions you have taken in connection with the grain embargo, the methods you used to close the markets on a short-term basis and, in addition, another issue which is of growing concern—perhaps concern is not the appropriate word—perhaps interest is. That is, the massive expansion of futures into nontraditional areas, whether they be financial futures, stock indexes, heating oil prices, gold, silver—a broad variety of things that were not traditionally involved in the trading of futures.

These things interest me. They interest economists in general. The committee and I appreciate the fact that you came down here. I hope we can hear some good evidence and testimony from you on these subjects.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Danny. Does any other member of the subcommittee have a statement that they would like to make?

[No response.]

Mr. JONES of Tennessee. If not, Chairman Stone, we are delighted you are here. I believe that other members of the Commission are also with you as well as your entourage of assistants. We are also delighted to see James Culver here. Jim was with us before he chose to go to CFTC.

You may proceed, Mr. Stone.

STATEMENT OF JAMES M. STONE, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

Mr. STONE. Thank you, Mr. Chairman.

Good morning, Mr. Chairman and members of the subcommittee. My name is James M. Stone. I am Chairman of the Commodity Futures Trading Commission. This is my first opportunity to

appear before you, as you mentioned in your opening remarks, as Chairman of the CFTC, and I am delighted to be here.

At the table with me today are the five senior staff directors of the Commission. On my left are the Executive Director, Mr. Donald L. Tendick and our General Counsel, Mr. John G. Gaine. On my right are the Director of the Division of Enforcement, Mr. John A. Field III; the Director of the Division of Trading and Markets, Mr. John L. Manley and the new Director of the Division of Economics and Education, Dr. James A. Culver. During today's meeting I hope you will permit me to call upon staff to provide information in response to some of your questions.

Mr. JONES of Tennessee. Chairman Stone, before you continue, the full Committee on Agriculture is meeting next door. We have a quorum call. We will recess for a few moments and then ask all the subcommittee members to come back.

[Whereupon, the subcommittee, at 10:15 a.m., stood in recess.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting and Chairman Stone, you may proceed. I hope that we will not have any more interruptions, but no doubt we will have.

Mr. STONE. I understand, Mr. Chairman.

I have introduced myself and my staff here at the front table. Also with us today is the full Commodity Futures Trading Commission. Commissioner Read P. Dunn, Jr., Commissioner Robert L. Martin, and Commissioner David G. Gartner are available to answer any questions you may have of them. The Commission has requested, however, that I serve, whenever possible, this morning as spokesman for the Commission. Other than in response to the questions of the subcommittee, if the Commissioners feel it is useful to comment further on specific matters raised today, they would like to be able to submit in writing brief additional remarks for the record within the next few days. We hope this arrangement is acceptable to the subcommittee.

Before answering questions that may be raised by members of the subcommittee, I would like your permission to offer some brief opening comments, first with respect to the management of the agency and then concerning some of our program activities over the past year.

The Commodity Futures Trading Commission wishes to develop the best possible managerial structure for the performance of its regulatory tasks. Since I assumed my duties in May as Chairman, management has been one of my top priorities. My interests and concerns are shared by the other Commissioners. The Commission has determined that a cornerstone principle of our budgetary philosophy will be to maximize the efficiency of our existing operations before considering a request to you for any increase in our personnel ceiling. It is a mistake for any public official to seek additional resources until those the Congress has already made available are utilized in the most efficient manner possible.

The organization structure of the agency has therefore been reviewed with exceptional care in recent months. We have made a number of important changes. In order to eliminate any confusion about lines of authority, the Commission has clarified its reporting structure. Regional office program managers now report to their program supervisors in Washington rather than to an independent

regional director. As a result, every employee in the agency, except those in the offices of Commissioners, is ultimately responsible to one of the senior officers seated at this table. Each of the senior staff officers here has been authorized to have two deputies to aid in the management of the various sections and units for which he is responsible. Each has prepared a straightforward chart of the reporting lines beneath him. We hope that the clear definition of responsibility and accountability within the agency will contribute to increased efficiency and effectiveness in the use of our staff resources.

The Commission has paid specific managerial attention to its handling of commodity customer reparation cases. In order to reduce the lag time between the filing of a customer complaint and its ultimate resolution, the Commission is planning a new complaints unit for the initial processing and screening of cases. We will shortly consider new rules which may help eliminate nonmeritorious cases and speed resolutions between the parties where appropriate in other cases. The Commission will be pleased to keep you advised as our new approaches are implemented and tested.

In addition to organizational changes, a number of staffing changes have also been made. Our continuing goal is to find public servants having the strongest professional credentials, the highest moral character and demonstrated ability to develop an understanding of the futures industry and the needs and concerns of its economic users. Since May 1979 we have brought on a new Director and two Deputy Directors for the Division of Trading and Markets, a new Deputy Director for the Division of Enforcement, a new Director of the Division of Economics and Education, a new Deputy Director in the Office of the Executive Director and new Chiefs of three Commission staff offices. Some of these appointments went to individuals with years of service at the CFTC. Some of the new employees came from private industry and some had developed valuable experiences at other Government agencies. The Commission is proud of the caliber of our professional staff and will set high expectations in future hirings. We are still recruiting at this time, principally for attorneys, economists, and accountants, but the Commission will fill its vacancies only as we find people who meet our standards.

In turning now to program activities, I would like to highlight only a few of the important events of the past year. First among these is the action of the CFTC with respect to March wheat on the Chicago Board of Trade.

No event in the last year has been of greater precedential value. The background of the situation is well known. In the face of a tight supply situation at Chicago and Toledo, as well as shortages of transportation and warehouse space, the CFTC learned that a small number of speculators held long positions substantially in excess of the known deliverable supply of wheat. The prices of the March wheat futures were being moved to unusually high levels and above those in the corresponding cash markets. These facts and others led the Commission to take emergency action. On March 16, 1979, the Commission voted to prohibit any further trading in the March contract. The Chicago Board of Trade promptly sought and received a preliminary injunction in the U.S.

district court. This prevented the Commission from enforcing its emergency action.

On March 28, 1979, this subcommittee conducted a hearing concerning the Commission's actions in connection with trading in March wheat and the litigation which followed. Both the Commission and the Board of Trade testified here in detail.

During the testimony, we advised you that the Commission was appealing the district court's decision in order to avoid its adverse impact on the Commission's ability to carry out its responsibilities under the Commodity Exchange Act. I am pleased to report that on September 12, 1979, the Court of Appeals for the Seventh Circuit reversed the district court's opinion. The Commission believes the appeals court decision to have been highly significant in strengthening the hand of the CFTC during market emergencies.

Sometimes, an event is important for what did not happen. One action the Commission did not take in 1979 is worth mentioning in that context. We postponed for 1 year, or until the receipt of a petition from three Commissioners, all consideration of a regulatory scheme that would permit exchange trading of commodity options. The Commission does not believe that past problems with off-exchange options should necessarily doom exchange traded options as a concept forever. Nor is the Commission unwilling to consider arguments that there is a valuable economic purpose to be served by some option instruments. On the other hand, we are extremely mindful of our instruction from the Congress not to proceed with commodity options until we can document to you our ability to regulate them successfully. It was our judgment that, given a series of open questions about the most appropriate form of customer protection rules and the strains that an option program would place on Commission resources, we could not effectively meet the test of documentation you have imposed. We remain open minded on the subject of commodity options but, if we proceed, it will be with all warranted caution.

The final event of recent days I wish to highlight is the Commission's use of its emergency powers 5 weeks ago to suspend grain futures trading for 2 days in the wake of the President's action to restrict grain sales to the Soviet Union. Following the Soviet Union's invasion of Afghanistan on December 27, President Carter announced on January 4 that sales of grain, technology, and strategic materials to the Soviet Union would be sharply curtailed. In one evening, the domestically available supply of corn was potentially increased by some 12 million tons. The supply of wheat was potentially increased by 4 million tons and the supply of soybeans by 1 million tons.

The Commission immediately initiated consultation with market users, and an emergency meeting of the Commission was scheduled for Sunday afternoon, January 6. By that time, it was clear that there existed a nearly unanimous chorus of requests from farm groups and commercial hedgers for a temporary suspension of futures trading in the commodities affected by the sales restrictions. Among the organizations favoring a suspension were the National Association of Wheat Growers, the National Corn Growers, the American Soybean Association, the National Council of Farm

Cooperatives—virtually every major grain company and several futures commission merchants.

The Commission listened very carefully to these market users and after extensive consideration we voted a 2-day suspension in the trading of futures for six commodities.

It was our view that the sudden shock to the market and the uncertainties concerning soon to be announced USDA compensatory plans would render the markets temporarily incapable of accurately reflecting either supply or demand.

It was known to all that roughly half a billion bushels of grain and soybeans would not be delivered to the Soviet Union but, had the markets opened as usual on Monday, the trading would only have reflected speculation about the nature of the administration's yet unannounced program of price supports and contract assumption. Every day of limit down price movements would have produced margin calls in excess of \$400 million. Dislocation of this magnitude, on very short notice, could have had adverse effects on banks and brokers along with the market participants. Then, if the prices had rebounded when the compensatory program was announced, equal margin calls would have gone out to the shorts. This kind of purposeless volatility serves no one well.

The 2-day trading suspension gave the market time to evaluate the information available and to consider the USDA support programs along with the original restriction announcement. Corn, wheat, and soybeans traded down their limits on Wednesday, but by Friday they had all begun to rally. They are now trading near or above their preannouncement levels. There was no market panic. We had some difficult judgment calls to make in deciding which markets would be closed and for how long, but I believed then, and I believe now, that we took the minimum necessary action under the circumstances. That is the standard we should use any time we exercise our potent emergency powers.

There are, of course, many other important subjects worthy of discussion. Recent months have seen the filing of a number of significant enforcement actions, most recently one developed in cooperation with the State of New York and numerous other State enforcement offices against more than 60 alleged sellers of fraudulent oil futures contracts.

In the months to come, the Commission will be considering complex issues such as reporting requirements for foreign traders, proposals to establish trading in stock-index futures and regulation of the dealer options market. We will be reviewing recent actions by the exchanges and by market participants in the precious metals markets and the cattle futures market. With respect to the past and present status of these and other issues, I hope we will be prepared to answer all questions any member of the subcommittee may have.

We will be more limited, of course, in the extent to which we can answer questions about future actions. I will not be able to tell you, for example, how the commission, or I personally, can be expected to vote on any issue yet to come before us. Our procedures require us to make those judgments based on the record at the time of the vote including staff recommendations, public comments and open Commission discussion.

In closing, I would like to express my thanks for this opportunity to meet with our oversight committee and answer your questions. The Commission hopes that the exchange of information between the CFTC and its congressional parent body will be frequent and fruitful.

Mr. JONES of Tennessee. Thank you very much, Chairman Stone. Will you be here for the day?

Mr. STONE. Yes, sir.

Mr. JONES of Tennessee. We will hear the next witness, Mr. Robert Carswell, Deputy Secretary, U.S. Department of the Treasury, Washington, D.C.

Mr. SCHMIDT. Mr. Chairman, I do not think he expected to be called until 11.

Mr. JONES of Tennessee. Mr. Stone, if you do not mind, we will allow the subcommittee to ask you questions now.

Mr. STONE. I am at your disposal, sir.

Mr. JONES of Tennessee. Mr. Glickman.

Mr. GLICKMAN. I thank you for your statement, Mr. Stone.

First of all, I would like to compliment you. I have heard from many people, particularly during the days when we were deciding what to do to protect the market with respect to the grain embargo, that you were very aggressively espousing the interests of the American farmer. People have related that to me. It has been a concern of mine for some time. One of the CFTC's original purposes was the protection of commodity markets, and I think you did a good job.

I would like to ask you questions in two basic areas. One is that, as I understand the situation, at the time the President announced the grain embargo, most decisions were not made in connection with what was going to happen with the markets, how those markets were going to be protected. You have indicated in your testimony here that you talk to a lot of farm organizations and got their feeling about what to do to protect the market. To the extent that you can relate them, what conversations did you have with the administration and the Secretary of Agriculture and who initiated the discussion as to how you were to best protect the markets? Under the statute that is not within their control. It is within your control. Will you give us some clarification?

Mr. STONE. I would be happy to give you some background. The members of the Commission first learned about the President's intended action on Friday, at the time of the President's public announcement. Immediately, we began to make telephone contacts within the Commission, that is, among the Commissioners and the Commission staff. By Saturday noon we had initiated extensive contacts with market users to find out what their reactions were and what they felt needed to be done. At approximately the same time as I was making these phone calls from my home, I received a call from Secretary Bergland, who indicated to me that he hoped that we would be able to work closely and cooperatively together in coordinating any action that might be taken that would affect both the futures markets and the cash markets at the same time.

I told Secretary Bergland that I would let him know the results of our contacts with market users and that I would inform him of any planned emergency Commission meeting. At that time we had

not decided when to hold such a meeting. Later in the day, at about 4, I called Secretary Bergland back and told him that it was the unanimous view of the Commission that we should meet the next day, Sunday, in emergency session to discuss whether there should be a suspension of futures trading.

At that time, I believe, he told me that he was having a meeting the next day with the major grain companies and others who were directly affected and had contracts with the Soviet Union. I asked him if it would be appropriate for me to attend that meeting, and he said he felt it would be fully appropriate.

So, on Sunday morning, Dr. Culver and I attended a meeting with Secretary Bergland and other senior personnel from the U.S. Department of Agriculture. We listened as the grain companies' representatives and others who had contracts told their side of the story. In the afternoon, we had our Commission meeting. At that time, Mr. Dawson Ahalt, who performs the function laid out by statute of coordinating the two agencies, attended our meeting, as he frequently does—

Mr. GLICKMAN. Is he an employee of the Department?

Mr. STONE. He is the employee of the Department of Agriculture, yes. He is a regular attendee at our meetings by our invitation. Following what we understand to be a statutory mandate, he encourages very close contact between us and the Department of Agriculture.

He attended our meeting in the afternoon and was present at the time of the vote.

I think I have relayed to you all the contacts prior to our action. If I had left anything out—

Mr. GLICKMAN. Did the administration seek the closing of the grain markets? I realize you took the action, but did the Secretary ask you to do that?

Mr. STONE. At our meeting on Sunday, Mr. Ahalt conveyed to us, on behalf of the Secretary, a feeling that at least for some period of time in some markets a suspension would be useful. I do not believe that a specific recommendation as to which markets should be closed or for what period of time was conveyed to us. I can assure you that the Commission took that input along with all of the other inputs as one factor in its decision, but no single piece of advice was overriding.

Mr. GLICKMAN. Although my time is up, I would say that, without knowing all the details, I compliment the Commission on bringing order to a period that was otherwise lacking in sanity. I think that you have restored some faith in the fact that the CFTC could have prevented some catastrophe from occurring in the market.

I would like to ask one more question. I would surely like the Commission to furnish us with market volume figures showing trading in the variety of different types of futures under your jurisdiction over the last few years. We would like to get some determination of how much capital is flowing into the futures market.

While you cannot tell us what you will do in the future, can you relate to the panel what exotic, or what new futures contract are coming before the Commission for consideration or are currently before the Commission?

Mr. STONE. First, with respect to your question about trading volume figures, we have those figures with us today.

Mr. JONES of Tennessee. Without objection, the trading volume figures which you have presented to us will be included in the hearing record.

[The material referred to above follows:]

Year	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030																																																																																																																																																																																																																																																																																																																																																																																																															
Trading Volume	1,000,000	1,200,000	1,400,000	1,600,000	1,800,000	2,000,000	2,200,000	2,400,000	2,600,000	2,800,000	3,000,000	3,200,000	3,400,000	3,600,000	3,800,000	4,000,000	4,200,000	4,400,000	4,600,000	4,800,000	5,000,000	5,200,000	5,400,000	5,600,000	5,800,000	6,000,000	6,200,000	6,400,000	6,600,000	6,800,000	7,000,000	7,200,000	7,400,000	7,600,000	7,800,000	8,000,000	8,200,000	8,400,000	8,600,000	8,800,000	9,000,000	9,200,000	9,400,000	9,600,000	9,800,000	10,000,000	10,200,000	10,400,000	10,600,000	10,800,000	11,000,000	11,200,000	11,400,000	11,600,000	11,800,000	12,000,000	12,200,000	12,400,000	12,600,000	12,800,000	13,000,000	13,200,000	13,400,000	13,600,000	13,800,000	14,000,000	14,200,000	14,400,000	14,600,000	14,800,000	15,000,000	15,200,000	15,400,000	15,600,000	15,800,000	16,000,000	16,200,000	16,400,000	16,600,000	16,800,000	17,000,000	17,200,000	17,400,000	17,600,000	17,800,000	18,000,000	18,200,000	18,400,000	18,600,000	18,800,000	19,000,000	19,200,000	19,400,000	19,600,000	19,800,000	20,000,000	20,200,000	20,400,000	20,600,000	20,800,000	21,000,000	21,200,000	21,400,000	21,600,000	21,800,000	22,000,000	22,200,000	22,400,000	22,600,000	22,800,000	23,000,000	23,200,000	23,400,000	23,600,000	23,800,000	24,000,000	24,200,000	24,400,000	24,600,000	24,800,000	25,000,000	25,200,000	25,400,000	25,600,000	25,800,000	26,000,000	26,200,000	26,400,000	26,600,000	26,800,000	27,000,000	27,200,000	27,400,000	27,600,000	27,800,000	28,000,000	28,200,000	28,400,000	28,600,000	28,800,000	29,000,000	29,200,000	29,400,000	29,600,000	29,800,000	30,000,000	30,200,000	30,400,000	30,600,000	30,800,000	31,000,000	31,200,000	31,400,000	31,600,000	31,800,000	32,000,000	32,200,000	32,400,000	32,600,000	32,800,000	33,000,000	33,200,000	33,400,000	33,600,000	33,800,000	34,000,000	34,200,000	34,400,000	34,600,000	34,800,000	35,000,000	35,200,000	35,400,000	35,600,000	35,800,000	36,000,000	36,200,000	36,400,000	36,600,000	36,800,000	37,000,000	37,200,000	37,400,000	37,600,000	37,800,000	38,000,000	38,200,000	38,400,000	38,600,000	38,800,000	39,000,000	39,200,000	39,400,000	39,600,000	39,800,000	40,000,000	40,200,000	40,400,000	40,600,000	40,800,000	41,000,000	41,200,000	41,400,000	41,600,000	41,800,000	42,000,000	42,200,000	42,400,000	42,600,000	42,800,000	43,000,000	43,200,000	43,400,000	43,600,000	43,800,000	44,000,000	44,200,000	44,400,000	44,600,000	44,800,000	45,000,000	45,200,000	45,400,000	45,600,000	45,800,000	46,000,000	46,200,000	46,400,000	46,600,000	46,800,000	47,000,000	47,200,000	47,400,000	47,600,000	47,800,000	48,000,000	48,200,000	48,400,000	48,600,000	48,800,000	49,000,000	49,200,000	49,400,000	49,600,000	49,800,000	50,000,000	50,200,000	50,400,000	50,600,000	50,800,000	51,000,000	51,200,000	51,400,000	51,600,000	51,800,000	52,000,000	52,200,000	52,400,000	52,600,000	52,800,000	53,000,000	53,200,000	53,400,000	53,600,000	53,800,000	54,000,000	54,200,000	54,400,000	54,600,000	54,800,000	55,000,000	55,200,000	55,400,000	55,600,000	55,800,000	56,000,000	56,200,000	56,400,000	56,600,000	56,800,000	57,000,000	57,200,000	57,400,000	57,600,000	57,800,000	58,000,000	58,200,000	58,400,000	58,600,000	58,800,000	59,000,000	59,200,000	59,400,000	59,600,000	59,800,000	60,000,000	60,200,000	60,400,000	60,600,000	60,800,000	61,000,000	61,200,000	61,400,000	61,600,000	61,800,000	62,000,000	62,200,000	62,400,000	62,600,000	62,800,000	63,000,000	63,200,000	63,400,000	63,600,000	63,800,000	64,000,000	64,200,000	64,400,000	64,600,000	64,800,000	65,000,000	65,200,000	65,400,000	65,600,000	65,800,000	66,000,000	66,200,000	66,400,000	66,600,000	66,800,000	67,000,000	67,200,000	67,400,000	67,600,000	67,800,000	68,000,000	68,200,000	68,400,000	68,600,000	68,800,000	69,000,000	69,200,000	69,400,000	69,600,000	69,800,000	70,000,000	70,200,000	70,400,000	70,600,000	70,800,000	71,000,000	71,200,000	71,400,000	71,600,000	71,800,000	72,000,000	72,200,000	72,400,000	72,600,000	72,800,000	73,000,000	73,200,000	73,400,000	73,600,000	73,800,000	74,000,000	74,200,000	74,400,000	74,600,000	74,800,000	75,000,000	75,200,000	75,400,000	75,600,000	75,800,000	76,000,000	76,200,000	76,400,000	76,600,000	76,800,000	77,000,000	77,200,000	77,400,000	77,600,000	77,800,000	78,000,000	78,200,000	78,400,000	78,600,000	78,800,000	79,000,000	79,200,000	79,400,000	79,600,000	79,800,000	80,000,000	80,200,000	80,400,000	80,600,000	80,800,000	81,000,000	81,200,000	81,400,000	81,600,000	81,800,000	82,000,000	82,200,000	82,400,000	82,600,000	82,800,000	83,000,000	83,200,000	83,400,000	83,600,000	83,800,000	84,000,000	84,200,000	84,400,000	84,600,000	84,800,000	85,000,000	85,200,000	85,400,000	85,600,000	85,800,000	86,000,000	86,200,000	86,400,000	86,600,000	86,800,000	87,000,000	87,200,000	87,400,000	87,600,000	87,800,000	88,000,000	88,200,000	88,400,000	88,600,000	88,800,000	89,000,000	89,200,000	89,400,000	89,600,000	89,800,000	90,000,000	90,200,000	90,400,000	90,600,000	90,800,000	91,000,000	91,200,000	91,400,000	91,600,000	91,800,000	92,000,000	92,200,000	92,400,000	92,600,000	92,800,000	93,000,000	93,200,000	93,400,000	93,600,000	93,800,000	94,000,000	94,200,000	94,400,000	94,600,000	94,800,000	95,000,000	95,200,000	95,400,000	95,600,000	95,800,000	96,000,000	96,200,000	96,400,000	96,600,000	96,800,000	97,000,000	97,200,000	97,400,000	97,600,000	97,800,000	98,000,000	98,200,000	98,400,000	98,600,000	98,800,000	99,000,000	99,200,000	99,400,000	99,600,000	99,800,000	1,000,000,000

PERCENT CHANGE IN AVERAGE MONTHEND OPEN INTEREST, VOLUME OF
FUTURES TRADING AND CONTRACTS SETTLED BY DELIVERY FOR FISCAL
YEAR ENDED SEPTEMBER 30, 1979 RELATIVE TO FISCAL YEAR ENDED
SEPTEMBER 30, 1978

Commodity	Percent Change of Open Interest	Percent Change of Volume of Trading	Percent Change of Contracts Settled by Delivery
Wheat	+ 10.7	+ 27.3	- 31.5
Corn	+ 20.3	+ 26.9	+ 37.0
Oats	+ 32.7	+ 39.1	+101.2
Soybeans	+ 21.6	+ 21.1	+115.6
Soybean Meal	+ 19.9	+ 20.2	+ 60.0
Soybean Oil	+ 17.4	+ 11.7	- 30.8
Cotton	+ 27.0	+ 63.5	+ 43.7
Eggs	- 55.4	- 70.1	- 2.2
Potatoes	- 47.2	- 45.7	- 74.7
Frsm. Con. Org. Juice	- 33.2	- 44.3	+ 17.1
Cattle	+ 14.1	+ 39.7	+303.1
Frsm. Boneless Beef	+ 59.7	+225.0	+ 36.8
Live Hogs	+ 25.3	+ 0.8	+127.5
Frsm. Pork Bellies	+ 52.2	- 0.7	- 40.7
Silver	- 12.2	+ 31.9	+ 15.1
Gold	+123.4	+103.2	+ 16.7
Copper	+ 9.0	+ 80.2	- 6.3
Silver Coins	- 50.0	- 48.8	+ 12.7
Platinum	+ 23.7	+ 31.7	- 6.3
Palladium	+ 0.2	+ 1.5	- 41.6
Zinc	- 50.9	- 66.7	+ 73.4
Sugar	+ 13.7	+ 31.4	+ 32.9
Cocoa	- 15.3	- 6.9	+149.1
Coffee	+105.7	+119.1	+506.3
Heating Oil	—	—	—
Industrial Fuel Oil	—	—	—
Propane	- 75.0	—	0
Iced Broilers	- 15.9	- 53.4	- 31.1
Lumber and Studs	+ 6.7	+ 19.8	+ 80.7
Plywood	- 39.1	- 43.6	- 66.2
GMA Mortgages	+166.5	+ 75.0	+543.5
Treasury Bills (90 Day)	+158.0	+201.3	+ 47.8
Treasury Bills (1 Yr.)	+122.6	+534.8	—
Foreign Currencies	+ 51.7	+534.8	- 22.3
Comm. Paper (90 Day)	+104.9	+221.7	—
Comm. Paper (30 Day)	—	—	—
T-Bonds	+295.2	+435.3	+219.7
T-Notes (4-6 Yr.)	—	—	—
T-Notes (4 Yr.)	—	—	—
Total	+ 23.3	+ 40.4	+ 29.1

—Indicates figures necessary for percentage change calculations were unavailable

Estimated Average Monthend Open Interest, Volume of Futures
Trading and Total Deliveries, By Commodity, All Markets Combined,
For the Fiscal Years Ending September 30, 1979 and September 30, 1978

Commodity	Contract Unit	Open Interest		Volume of Trading		Total Deliveries	
		1978-79	1977-78	1978-79	1977-78	1978-79	1977-78
		(Contracts)	(Contracts)	(Thousand Contracts)	(Thousand Contracts)	(Contracts)	(Contracts)
Wheat	5,000 bu.	71,088	67,484	4,361.7	3,423.8	12,534	25,868
Corn	do	139,869	132,870	7,951.4	6,364.9	39,813	33,353
Soybeans	do	8,404	4,823	229.4	172.3	10,418	5,178
Soybean Meal	5,000 bu.	125,904	180,517	9,822.8	8,188.4	36,925	37,387
Soybean Oil	100 tons	33,303	44,634	2,829.9	2,355.0	26,113	16,518
Cotton	40,000 lbs.	37,898	48,329	3,180.4	2,775.7	5,784	8,364
Cotton	30,000 lbs.	37,234	29,300	1,549.3	947.3	3,489	1,844
Eggs	32,500 doz.	782	1,683	29.5	50.5	448	458
Potatoes 1/	1/	8,434	12,957	269.3	495.7	111	439
Prun. Can. Orange Juice	15,000 lbs.	8,364	12,514	203.3	364.9	5,397	4,607
Cattle 2/	1/	100,238	87,883	8,134.1	5,184.1	10,705	1,773
Prun. Boneless Beef	34,000 lbs.	436	273	14.5	4.4	509	372
Live Hogs	1/	26,127	30,859	1,895.4	1,880.0	694	305
Prun. Pork Bellies	30,000 lbs.	15,171	9,963	1,430.1	1,440.0	721	1,214
Silver 3/	5,000 Tr. ows.	410,677	467,999	9,374.6	6,347.0	70,293	81,009
Gold 4/	100 Tr. ows.	243,824	189,184	10,231.7	5,045.7	74,406	82,414
Copper	25,000 lbs.	55,184	48,784	2,187.4	1,219.3	37,367	29,518
Silver Coins	\$10,000	814	1,629	4.5	12.7	1,356	1,303
Platinum	50 Tr. ows.	9,271	7,493	327.4	347.7	2,201	2,351
Palladium	100 Tr. ows.	1,905	1,901	47.3	46.4	943	1,447
Alum	60,000 lbs.	38	53	2	6	111	84
Sugar	112,000 lbs.	42,581	37,454	1,277.2	872.1	12,132	9,128
Cocoa	30,000 lbs.	7,014	8,283	324.9	361.4	685	275
Coffee	37,500 lbs.	8,723	4,341	355.8	163.4	6,421	1,899
Heating Oil 5/	42,000 U.S. gal.	564	—	10.6	—	362	—
Industrial Fuel Oil 5/	42,000 U.S. gal.	3	—	—	—	2	—
Propane	100,000 gal.	21	84	3/	3/	0	0
Feed Brillers	30,000 lbs.	1,803	2,144	33.2	71.3	1,342	2,238
Lumber and Stude	100,000 bd. ft.	8,676	9,122	644.7	338.0	618	342
Vlywood	76,032 bd. ft.	4,006	6,714	169.4	300.3	2,017	3,976
GNM mortgages	\$100,000 prin. bal.	77,064	28,913	1,324.9	737.0	6,152	934
Treasury Bills (90 Day)	\$1,000,000	32,641	20,404	1,608.3	532.5	1,457	964
Treasury Bills (1 Year)	\$250,000	1,638	736	14.6	2.3	1,199	0
Foreign Currencies	10/	34,237	22,378	2,003.7	1,345.5	8,361	8,830
Comm. Paper (90 Day)	\$1,000,000	1,453	709	41.5	12.9	264	29
Comm. Paper (30 Day) 11/	\$3,000,000	105	—	1.3	—	9	—
T-Bonds	\$100,000	49,503	12,527	1,360.8	291.4	10,393	3,513
T-Notes 12/ (4-6 Year)	\$100,000	2,280	—	9.6	—	674	—
T-Notes 13/ (4 Year)	\$100,000	1,724	—	9.6	—	0	—
Total		1,867,287	1,368,094	72,348.9	51,686.5	402,075	311,537

1/ Includes russet potatoes (formerly Idaho potatoes), and round white potatoes (formerly Maine potatoes).

2/ Russet potatoes contracts of 80,000 pounds. Round white potatoes contracts of 30,000 pounds.

3/ Includes live beef cattle and feeder cattle.

4/ Live beef cattle contracts of 40,000 pounds. Live feeder cattle contracts of 42,000 pounds.

5/ Chicago Mercantile Exchange contracts of 30,000 pounds. MidAmerica Commodity Exchange contracts of 15,000 pounds.

6/ Chicago Board of Trade and Commodity Exchange, Inc. contracts of 5,000 tray ounces. MidAmerica Exchange contracts of 1,000 tray ounces.

7/ Commodity Exchange, Inc. contracts of 100 tray ounces. Chicago Board of Trade contracts of 100 tray ounces and 5 kg. New York Mercantile Exchange contracts of 1 kg. and 400 tray ounces. MidAmerica Commodity Exchange contracts of 1 kg. and 33.3 tray ounces.

8/ Trading began November 14, 1978.

9/ Less than 50 contracts.

10/ Contract units for individual currencies were used.

11/ Trading began May 14, 1979.

12/ Trading began June 23, 1979.

13/ Trading began July 10, 1979.

STATUS OF FUTURES TRADING FISCAL YEAR 1978 1/
Active Contracts on Markets Designated by CFTC

<u>Exchanges</u>	<u>Contracts 2/</u>
Chicago Board of Trade	Wheat, Corn, Oats, Soybeans, Soybean Oil, Soybean Meal, Iced Broilers, Silver, Gold (3 kg.), Gold (100 oz.), Plywood, Commercial Paper (30 Day), Commercial Paper (90 Day), GNMA Mortgages, GNMA Mortgage CD, Treasury Bonds, Treasury Notes (4-6 yr.)
Chicago Mercantile Exchange	Fresh Eggs, Russet Potatoes, Live Cattle, Live Hogs, Frozen Pork Bellies, Lumber, Live Feeder Cattle, Stud Lumber
International Monetary Market Division of the CME	British Pound, Canadian Dollar, Deutschmark, Dutch Guilder, Japanese Yen, U.S. Silver Coins, Mexican Peso, Swiss Franc, French Franc, Gold, Treasury Bills (90 day), Treasury Bills (1 year), Treasury Notes (4 year)
Commodity Exchange, Inc.	Copper, Silver, Gold, Zinc
Kansas City Board of Trade	Wheat
MidAmerica Commodity Exchange	Wheat, Corn, Oats, Soybeans, Silver, Live Hogs, Live Cattle, Gold (1 kg.), Gold (33.2 oz.)
Minneapolis Grain Exchange	Wheat
New York Cocoa Exchange	Cocoa (30,000 lbs.), Cocoa (10 m. tons)
New York Coffee and Sugar Exchange	Coffee "C", Sugar #11, Sugar #12

1/ Fiscal Year 1978 is the period October 1, 1978 through September 30, 1979.

2/ Traded during FY 1979.

<u>Exchanges</u>	<u>Contracts</u>
New York Cotton Exchange	Cotton
Citrus Associates of the New York Cotton Exchange	Frozen Concentrated Orange Juice
Petroleum Associates of the New York Cotton Exchange	Propane
New York Mercantile Exchange	Round White Potatoes, Imported Lean Beef, Gold (1 kg.), Gold (400 oz.), Silver Coins, Platinum, Palladium, British Pound, Canadian Dollar, Deutschmark, Japanese Yen, Swiss Franc, Heating Oil, Industrial Fuel Oil
AMEX Commodity Exchange	GNMA Mortgages CD, Treasury Bills (90 Day)

Mr. STONE. I would like to summarize for the members of the subcommittee of a few of the facts. One is that, much to the surprise of some traditional watchers of the market, while agricultural commodities remain the largest in volume of the commodities that we regulate, some of the nonagricultural futures have outstripped the agricultural growth very substantially. An example of this is that in interest rate futures, which are still a very small area in dollar terms, the growth has been enormous. Open interest in financial futures has increased some sixty-threefold over the last 4 years. That expansion is obviously enormous. We do not see at this time any attenuation of growth in the financial areas, and it is in the financial areas that we are also seeing the most—I believe you used the word exotic, I would say nontraditional—nontraditional of the contracts that have been submitted for our consideration. First among those, in terms of difficulty of analysis and perhaps importance in precedent, is the application we now have before us to trade a futures contract in a stock index. We have been told that there are other such proposals waiting for our consideration, presently being drawn up by the exchanges. Those may be submitted to us shortly if they have not been already.

Mr. GLICKMAN. Thank you.

Mr. JONES of Tennessee. I believe the gentleman from Kansas has used his time.

Gentlemen, I am going to ask you to try to hold to your time limit as much as possible. We will go back around again and give everyone an opportunity to question the Chairman once more.

I recognize Mr. Hance from Texas.

Mr. HANCE. I appreciate the opportunity to visit with you. I have talked to you before on various occasions about a couple of matters related to the embargo.

One of the problems that happened was, when the grain futures were shut down, cattle and especially live cattle immediately started to go down since they were not also closed. Most of the people who were long on grain immediately jumped into the cattle market. It took quite awhile—in fact it took longer for them than grain and soybeans—to rebound. Of course, we discussed this in hindsight and that is Monday morning quarterbacking. I would nonetheless anticipate that only in rare, rare circumstances do you have to do something like that.

Those markets do directly relate to each other, so I hope that if something like that every comes up again—I hope it will not—that either both go out or neither.

Another thing I discussed with you that I think is important—I believe you are familiar with the Tel-Cot operation in my district. There is a cotton classification and farmers can go into the cotton gins and sell their cotton. There is one related thing that we have asked the USDA to try and work on concerning live cattle futures. It would be something that would get more people involved in the futures market. I believe that until some type of classification comes forward that the producer has confidence in—and I use Tel-Cot as an example—I would hope that you and the USDA—although I am sure they would not move into it too fast—if you do, then you never will gain the credibility that it takes to develop that market.

We may be a long way off, but the classification would encourage more people to hedge. One thing that the American public has to realize is that the more farmers and ranchers hedge, the better off the American consumer will be and the more stability you will have in the market. We need more people to participate. Anything you can do to encourage more small producers to participate would be good.

I have one last statement, or actually it is a question to which I think I know the answer, I have had some people from my district inquire about it, so while I have you here I would like to ask you about it. At any time on Friday before the action that shut the markets on Monday, did you discuss with any producers or exporters of grain the possibility of shutting the market for 2 days? Did you or any of your Commissioners?

Mr. STONE. You asked about Friday? No; I think it is safe for me to say—I know it is safe for me to say for myself—that none of the Commissioners knew about the President's foreign policy action until the formal announcement of it was made. We are not consulted on foreign policy—

Mr. HANCE. I understand. I have had numerous inquiries about that, so I wanted it on record. When I respond to that correspondence, I can send a copy of it.

Mr. STONE. Thank you.

Mr. HANCE. Thank you.

Mr. GLICKMAN [acting chairman]. Mr. Madigan?

Mr. MADIGAN. Mr. Chairman, do you know what soybeans, wheat, or corn, or all three, were trading for prior to closing the market?

Mr. STONE. I am sure that I have those figures.

Mr. MADIGAN. As far as actual trading days were concerned, were the markets closed for 2-trading days?

Mr. STONE. Yes; Monday and Tuesday.

Mr. MADIGAN. The limit on corn, is it 20 cents a bushel?

Mr. STONE. I do not believe so. I believe it is 10.

Mr. MADIGAN. So, in a 2-day period of time, the maximum corn could have gone down would have been 20 cents. Is that correct?

Mr. STONE. I believe that is correct.

Mr. MADIGAN. Would 20 cents a bushel be the limit on beans?

Mr. STONE. No, sir. Corn is 10 cents, and on soybeans, I believe, it is 30 cents.

Mr. MADIGAN. And what is it on wheat?

Mr. STONE. I believe it is 20 cents on wheat.

Mr. MADIGAN. So, in a 2-day period of time we are not talking about a lot of price movement occurring.

I have not made up my mind, but I am trying to decide whether or not the closing of the market was the correct thing to do.

Mr. STONE. I think in dollar terms we are talking about a very substantial movement. As I think I mentioned in my opening statement, it would have involved in margin calls, which are a measure of how much the market is moving, something in the vicinity of \$400 million a day if corn, wheat, and soybeans had been down to the limit.

Mr. MADIGAN. That is a substantial amount of money certainly, but expressed in terms of the amount of activity that goes on on

the exchange, is that such a large amount of money? For example, if the amount that corn can go down is 10 cents a bushel and the price of corn is \$2.50 a bushel, then we are talking about the margin call being equivalent to about 5 percent of the amount of money that is involved in the market in corn in 1 day. Is that not correct?

Mr. STONE. I think that percentage figures in that respect are somewhat misleading. These are enormous markets, and I think that the absolute dollar terms are probably better measures of what the impact on users would be. To have to raise that kind of margin money in a very short period of time would have been quite difficult for some, I believe.

Mr. MADIGAN. But the people who are engaged in that kind of activity are not the farmers or the country elevator operators, who would have to think about coming up with millions of dollars. Those are people who when faced with that obligation are normally doing business in terms of million of dollars. Are they not?

Mr. STONE. Congressman, I think you are mistaken in suggesting that farmers and country elevator operators would not have been involved in the markets—

Mr. MADIGAN. I did not say that. I mean, they would not be involved in terms of millions of dollars of activity in margin calls. We would not be talking about farmers or country elevator operators when we are talking about that kind of substantial financial requirement.

Mr. STONE. That is certainly correct. Out of the \$400 million the largest pieces would be those of the largest participants in the markets. But to a smaller user in the markets I think that a margin call in the thousands or ten thousands of dollars could be quite significant, for example, to an individual farmer or country elevator operator.

Mr. MADIGAN. Perhaps you answered this in your exchange with Mr. Glickman, and if you did I hope you will excuse my redundancy. Did Mr. Glickman ask you whether or not these people to whom you refer in your statement as supporting the closing of the market contacted you, or did the Commission contact them initially? Exactly what happened?

Mr. STONE. I am not sure in each case. Dr. Culver may want to supply some additional detail. In general I asked Dr. Culver and other senior staff members of the Commission on Saturday morning to begin to try to reach all of the market users that they could find and their representative groups in Washington, so I believe that in most cases we probably initiated the contact. In some cases they may have called us before we called them—

Mr. MADIGAN. Would the contact with Secretary Bergland have preceded that?

Mr. STONE. Do you mean by initial phone call from Secretary Bergland?

Mr. MADIGAN. That is correct.

Mr. STONE. That phone call happened as the whole series of telephone calls was beginning. I am not certain whether it was right before or right after my phone call to Dr. Culver.

Mr. MADIGAN. Are you aware that the Wall Street Journal carried a story that said an Under Secretary was contacting business-

men across the country and giving them advance notice of the President's intention to announce an embargo?

Mr. STONE. I had not heard that, sir.

Mr. MADIGAN. The story was in the Wall Street Journal.

Mr. STONE. I had not heard that.

Mr. MADIGAN. It seems interesting to hear that we have a Government agency contacting people to elicit whether or not an action would be beneficial to their financial decisions, that is, if we would close the market. Also, a newspaper carrying a story that certain businessmen across the country were given advance notice. Apparently, we have been very solicitous here as a Government in protecting the interests of certain people. A reasonable person would reach that conclusion.

What was the Commission vote on closing of the markets?

Mr. STONE. Ordinarily we are reluctant to reveal the votes during a closed meeting, but in this case it was specifically agreed by the Commissioners present that we would make it clear that it was a unanimous vote. There were three of us present, and it was a 3-to-0 vote.

Mr. MADIGAN. I would like to question you for just a moment, if I may, about the role of the chairman as you view that role. Is it your judgment that the Chairman of the Commission should try to develop a consensus of what the Commissioners want to do and then act as chairman to execute that decision? Or, do you see the Chairman as being a leader who makes a judgment as to what ought to be done and, in effect, asks the other Commissioners to ratify that?

Mr. STONE. The question you are asking is a difficult question of philosophy as well as practice and I am not sure that I can give you a simple answer. It is a little like the question of whether a legislator is his own man or a representative of his constituency.

I think that the Chairman's role contains a little of each element of what you just described. To some extent he is a consensus finder, and to some extent the Chairman has to be a focal point for leadership.

Mr. MADIGAN. Of course, my interest in that question is because of the newspaper publicity surrounding the possible appointment of a member of the Commission who was reported in the press to be "your guy," and I understand now that appointment has been withdrawn. Do you have some procedure you are following down there to interview possible candidates for membership on the Commission?

Mr. STONE. I was consulted in the initial choice that ultimately was not made and to which you have just referred. Since that time, I have stayed somewhat farther away from the process, since my own role in it was obviously a matter of some controversy. I might add that I think the candidate who was talked about at that time was somewhat unfairly treated in the process. Hugh Cadden had been an associate of Mr. Bagley's law firm before coming to the Commission, had come in as Mr. Bagley's man, had been promoted by Mr. Seever when he ran the Commission and had been awarded the honor of being chosen as the best employee within the agency during Mr. Seever's tenure, and then had been helpful to me. We had been recognized as an outstanding talent by all of the

Chairmen and I was sorry to see him in some way tarnished by being thought of being too close to me. I think it is a bit unfair.

Mr. MADIGAN. I understand that my time has expired. Thank you, Mr. Chairman.

Mr. GLICKMAN [acting chairman]. Mr. Baldus?

Mr. BALDUS. Regarding the decision in favor of the Commission's position by the court of appeals, will that ruling effect later injunctions? Is that your thought?

Mr. STONE. Mr. Gaine could answer in more detail than I, but I think the basic point that I was trying to make was that it removes the specter from the Commission of a trial de novo at the district court level whenever the Commission takes an emergency action. A trial de novo on the facts, and in the midst of an emergency, is not a good idea. Apparently the appeals court agreed that the intent of the Congress was not to have a trial de novo.

If you would like more legal comment, Mr. Gaine could fill you in.

Mr. BALDUS. Did the decision set a precedent? In other words, if you take a similar action will you get a similar injunction?

Mr. GAINE. No, Mr. Baldus. This case may not have completed its court route yet. It is likely that the Board of Trade will petition the Supreme Court for a review of the decision, but when all the dust is settled, this decision should hopefully serve as precedent. Certainly it would be in the seventh circuit and hopefully in other circuits so that no injunction or no temporary restraining order would be issued restraining us.

Mr. BALDUS. It was a Federal court; was it not?

Mr. GAINE. Absolutely it was. It would go to whatever is the appropriate scope of review for a Federal district court judge. I think if this case were brought to the attention of any Federal district court judge, it should be persuasive that he has a very very limited, if any, scope of review of the Commission's emergency actions.

Mr. STONE. Excuse me for a moment, Mr. Chairman. The witness you were looking for a little while ago I believe has just arrived. I would be happy to stand out of the way if you would like to take him now.

Mr. JONES of Tennessee. No. Without objection, we will continue with you.

Mr. ENGLISH. Mr. Chairman, I suggest that we move right along.

Mr. BALDUS. I see on page 9 of your testimony you say:

Recent months have seen the filing of a number of significant enforcement actions, most recently one developed in cooperation with eight State enforcement offices against more than 60 alleged sellers of fraudulent oil futures contracts.

I believe that in the past State offices have felt that they did not have a free hand in the prosecution of such cases in their jurisdictions and even that the CFTC, they felt, may have interfered with their prosecutions. There seems to have been a feeling that the CFTC feared a loss of power through precedents set in cases tried at the local level. Therefore, now, how would you characterize your relationships with local enforcement offices?

Mr. STONE. I would say they are improved but there is still room for additional improvement in cooperative efforts. The case that I mentioned in my opening statement is a good example of how it

can be done. That is a case in which the attorney general of the State of New York and the CFTC's enforcement staff worked closely and, I think, quite effectively together, and then other States were brought into it before the final action was taken.

It is, I think, quite important for us, given our national scope and limited resources, to have available to us the manpower of State enforcement officials when their antifraud laws are violated as well as our laws. I will certainly be doing everything I can to encourage cooperation in line with the congressional wording that the States can enforce their own antifraud laws, even in commodities cases.

If you would like to hear from Mr. Field, our Director of Enforcement, in some detail on State cooperation in enforcement actions, he could give you more detail now.

Mr. BALDUS. I am interested in that because I thought the Commission was in the wrong before. If there is a change, I am interested. Mr. Field?

Mr. FIELD. Mr. Baldus, in addition to the action that we filed with the State of New York against the oil companies for selling fraudulent futures contracts, we have also worked with the State of Minnesota in an action that they brought under section 60 as well, providing them with an expert witness to testify at their proceeding. Currently we are working with approximately 25 to 30 additional States in developing section 60 actions to be brought in the future.

I might add, however that section 8 of our act prohibits us from turning over, for instance, names and addresses of investors. That has created a very difficult situation for us. As a result of section 8 and, I believe, section 8(b) we have been unable to give the States the names of investors who have complained to us and I believe that some clarification may be necessary as to our—

Mr. BALDUS. Does that suggest proposed legislation?

Mr. FIELD. I beg your pardon?

Mr. BALDUS. I would be interested in helping you.

Mr. STONE. Congressman, if it should appear to us in the future that despite all our efforts to work closely with the States and theirs to work with us, which I do think are seeing a great deal of improvement, there is a statutory change needed, I would hope that we could draw something up jointly with the State associations and bring it to you. Congressional action would be our last resort and that is why you have not seen anything so far. We are going to see how far we can go under the present statute in cooperative efforts first.

Mr. BALDUS. Well, do not underestimate us. We are interested in strong enforcement.

Mr. STONE. Thank you, sir.

Mr. BALDUS. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Baldus.

The Chair now recognizes Mr. English.

Mr. ENGLISH. Mr. Stone, how confident do you feel of the Commission's and your knowledge concerning the impact that various actions might have upon the market? I am thinking particularly about an embargo type of situation.

Mr. STONE. The Commission has a well diversified group of members in terms of experience, and I think we have an excellent staff with a wealth of experience. We also have good cooperative relations with other agencies. I feel therefore that we can be as confident as it is possible to be, given the enormous complexities of some of the problems that we have to deal with.

Mr. ENGLISH. Is that a very confident, somewhat confident, or no confident?

Mr. STONE. We are as confident as I can imagine is appropriate under the circumstances. I do not know how we could be more confident by improving our staff or relations with other agencies. I think that we are in the right position. We just have very, very complex questions to deal with.

Mr. ENGLISH. How confident are you with regard to our understanding of the impact that various decisions have had in the past upon the market, given your understanding of the process and the things that took place?

Mr. STONE. Again, to the extent that we are talking about supply and demand markets in which thousands, if not tens of thousands, of different factors influence the forming of a price, I do not think that any economist could tell you he could isolate the effects of any one action and tell you it caused the price to go up or down by a specific amount.

Mr. ENGLISH. What about with respect to past embargoes? Do you understand what impact that had on the market?

Mr. STONE. Again, I think I would have to give the same answer. I can tell you what we felt was the likely impact. I can tell you what direction I now think, in hindsight, the impact took, but in complex supply and demand markets, I think no one can tell you exactly what the impact was.

Mr. ENGLISH. You are saying that you really do not know.

Mr. STONE. I am saying I probably know as well as I can be expected to know or as well as anybody knows. But nobody knows for sure what the impact on a supply and demand market of any particular action may be.

Mr. ENGLISH. Given the confidence that you have and your knowledge of the area, how long would you say that the impact of the embargo will be felt in the marketplace?

Mr. STONE. I am sorry. I apologize. I thought you were asking me about the impact of the Commission's action.

Mr. ENGLISH. No.

Mr. STONE. As to the impact of the President's action, I do not think that I have studied the question in sufficient detail that I would want to serve as spokesman on that issue.

Mr. ENGLISH. We have had several embargoes in the past. You have the history of the impact that they have had on the marketplace. You know whether they caused the market to go up or caused it to go down. I would think, given the economists and the expertise that hopefully you have on staff, that you would have some understanding of how they effected the market and to what degree they effected it, and with that information would be able to say what we can expect the effects of this one to be.

Mr. STONE. My job is to work with the other Commissioners in policing and protecting the integrity of the futures markets—

Mr. ENGLISH. I realize that, but does that not require some expertise and understanding of the market itself and the effects that various forces have upon it. I do not see how you could regulate the market, unless you understood what it was all about and what impact is likely.

If you say, we do not know whether an embargo will cause the market to go up or down, I think, in most cases history will indicate that they caused it to go down. I can understand your reluctance to say, well, I think the embargo will do this or that, in terms of amount of impact or the number of days that it will go down and how much it will go down, but I would think you would have some understanding of just what impact an embargo has on the market and how long that impact will be felt. Do you expect it to be 2 days, 6 months, 5 years? How long?

What I am getting at is and am trying to find out from you, since you are supposed to have some expertise and understanding of the market, is how long you expect the impact of this embargo to be felt.

Mr. STONE. I think I do have some understanding in that area, sir. I am reluctant, because I think it is outside of the scope of my job to talk about something which requires a great deal of study and reading and would also be quite controversial. Since it is outside of the scope of my job, I prefer to stay away from it.

I will say that I feel that the price behavior in those markets recently, which brought wheat and soybeans back up to their preannouncement levels, is certainly contrary to what some of the learned commentators said when the embargo was first announced. This fact, I think, is one more measure of just how complex all the factors that underlie these markets are.

Mr. JONES of Tennessee. The time of the gentleman from Oklahoma has expired.

I now recognize Mr. Coleman.

Mr. COLEMAN. Thank you, Mr. Chairman.

Earlier you responded to one of Mr. Glickman's questions, regarding some of the less traditional futures markets that are being developed, and you mentioned the stock exchange index.

Mr. STONE. Yes.

Mr. COLEMAN. What is your feeling regarding jurisdictional matters over such a concept comparing your agency with, let us say, the SEC. What relationship should there be, and what are your personal feelings regarding jurisdictional authority over such matters?

Mr. STONE. I think it is safe to say that the Commission feels that we have jurisdiction over all futures instruments. There are some difficult jurisdictional issues raised here, however, that I believe may take many months, if not years, to iron out. It is conceivable that another agency might argue that it has concurrent jurisdiction whatever the CFTC might decide its jurisdiction to be. The Federal Reserve Board has already told us, and stated publicly, that it intends to impose margin requirements if there should be any such index in the future. That would be the first time that that has ever been asserted with respect to a futures instrument.

There are many difficult issues that would be raised by the trading of any stock market index. I do not claim that I have the answers to those questions now.

Mr. COLEMAN. But your own feeling is that the CFTC would be the initial regulatory agency. Is that correct?

Mr. STONE. I believe it is the view of the CFTC that the initial decision is ours.

Mr. COLEMAN. What would be some of the positive aspects of having a stock exchange index on the futures market?

Mr. STONE. I will be happy to answer that question, but I would like to preface my answer by saying that there may be positive aspects and negative aspects. I am not 100 percent convinced yet in my own mind of the merits of the cases on either side, but I can repeat to you some of the arguments I have heard as to what the positive aspects would be if—

Mr. COLEMAN. Which ones do you believe?

Mr. STONE. I do not think I want to sit here and make a positive case for you for stock market futures, other than to say that I believe that there is some market supply and demand and where there is commercial interest in having an instrument, there is, in fact, some indication that it would perform what, in some people's minds, would be a useful economic function.

I can imagine some people saying that having an ability to, in effect, take a position in an individual stock and then a position counter to that in an index would allow them to have the benefits of any price movement in the individual stock with the impact of the whole market's movements weeded out. They might find that an advantageous way to participate in the stock market. That is one argument I have heard.

Mr. COLEMAN. With the public interest in gold, silver, and other metals, has your agency discovered an increase in fraud or shyster operations, and if so, what are you doing to respond to those?

Mr. STONE. I am hesitating only because you used the word increase. We have had problems over the years with unscrupulous operators, particularly in the nonagricultural commodities, selling illegally and sometimes quite fraudulently certain instruments to customers. Whether there has been a tremendous increase in this type of activity, I do not think I have figures on. Perhaps Mr. Field does.

Mr. Field, do you have anything to add?

Mr. FIELD. Beginning with fiscal year 1979, with respect to firms that are dealing in some kind of off-exchange instrument—gold, silver, other precious metals—the Commission has filed 34 actions both injunctive and administrative, naming about 100 firms and about 145 individuals. This does not include the recent action taken against the 67 oil firms and individuals.

Our investigations also indicate a tremendous increase in the offering of some kind of contract, be it deferred delivery, long term forward, however it is nominated, in these types of commodities. They classically run boiler rooms, cold calls, urge quick decisions, fail to disclose risks, commissions. What we have seen is almost a Who's Who in the commodity options scam, and it has taken an inordinate amount of resources to come to grips with it.

Getting assistance from the States, who are also interested in this type of thing, would I think relieve our division of enforcement of a great burden and would allow us to become involved in the traditional futures market activities.

Mr. COLEMAN. Mr. Chairman, if I may, I would like to ask one final question.

Mr. JONES of Tennessee. Certainly.

Mr. COLEMAN. Mr. Stone, there were press accounts indicating that some of the embargoed grain had had destination changes made on contracts to show that it was to go to the Soviet Union. Therefore, the grain companies would be involved in whatever buy-back the Government might make. Does any of this come under your jurisdiction, that is, the changing of destinations on contracts?

Mr. STONE. I do not believe so. That would be a cash market situation rather than a futures market situation.

Mr. COLEMAN. Thank you.

Mr. STONE. My general counsel agrees with me.

Mr. JONES of Tennessee. Thank you, Mr. Coleman.

The Chair now recognizes Mr. Daschle.

Mr. DASCHLE. I would certainly like to add my welcome, Mr. Stone, and to thank you for your testimony.

I have two concerns, both with regard to the actions taken by the CFTC. The first is the impact that it had on the big traders, and the second is the confidence or lack of it that exists concerning the next couple of months with regard to the actions taken.

I would like to follow up a little bit on some of the questions asked earlier. I understand that there was a larger than ordinary sale of grain on Friday prior to the embargo. To what cause would you attribute that fact?

Mr. STONE. That is an interesting question, Congressman. I have heard that myself and I have heard unsubstantiated rumors that there were leaks as to what the administration was thinking of doing, but I have no knowledge other than those unsubstantiated rumors.

Mr. DASCHLE. Has any of the CFTC staff looked into the question of whether or not there was prior notification to some of these people which would have then caused the sale of some of their stock?

Mr. STONE. Nothing along those lines has occurred at the Commission level, but let me check with Dr. Culver to see if anyone on his staff has inquired into it.

Mr. CULVER. Mr. Daschle, I do not think that anyone has. Our surveillance staff did look very carefully though at the large trader positions over the last few days before the embargo, and we did not find any unusual circumstances.

Mr. DASCHLE. You found none whatsoever?

Mr. CULVER. We found none that would have caused concern in the futures market. It would have been possible, of course, to take some positions in the cash that would not have shown up to our surveillance economists.

Mr. DASCHLE. Is there some time in this process when it might have shown up?

Mr. CULVER. They would not if they were in the cash market rather than in the futures.

Mr. DASCHLE. All right. Concerning the time immediately after you shut down for 2 days, did you find any unusual purchases as a result of the action by some of your bigger traders?

Mr. STONE. I think it is safe to say that the answer to that is no. The markets were quite orderly and did not have characteristics which were of great concern to the Commission in the week following the resumption of trading.

Mr. DASCHLE. When you make decisions related to futures, do you ever try to determine the impact of your actions on the basis, or do you always think of your actions only in terms of the futures market? In other words, how does the difference between the cash and futures markets play into your decisionmaking? I would like to know, for example, the basis on Friday as opposed to the basis a week later in some of the area markets. I understand there was a substantial difference there, even though the futures market had gone up somewhat.

Mr. STONE. I do not have basis figures for specific locations with me today, but we can certainly supply you with them. I suspect we can supply you with those on fairly short notice.

[The material supplied follows:]

Table 1 below shows the basis at delivery points for wheat, corn, soybeans, soybean oil and soybean meal on January 4 and January 11, 1979. In addition, we have included figures for January 18, 1979. As Table 1 indicates for a number of commodities, the basis had declined from January 4 to January 11, 1979. However, for wheat in Chicago, Toledo and Minneapolis and for hopper cars of corn in Chicago, there was either no change or an improvement in the basis over this period. By January 18th, the basis for the majority of these commodities had either strengthened or was unchanged relative to January 4th levels.

TABLE 1

Commodity	Grade	Delivery Point	Transportation Method	Futures Month	Basis		
					1/4	1/11	1/18
Wheat	Soft Red Winter	Chicago	Rail	Mar 80	-10	-10	-10
			Truck	"	-10	-10	-10
		Toledo	Truck	"	-20	-20	-25
	Dark No. Spring	Minneapolis	Truck	"	-10½	- 4½	- 3
	Hard Red Winter	Kansas City	Truck	"	- 5	-14	- 8
Corn	#2 Yellow	Chicago	Hopper car	"	-29	-20	-20
			Box car	"	-28	-35	-27
		Toledo	Truck	"	-23	-25	-22
			Truck	"	-28	-35	-32
Soybeans	#1 Yellow	Chicago	Truck	Jan 80	-28	-35	-19½
Soybean Oil		Chicago	--	"	+ 20	0	0
Soybean Meal		Chicago	--	"	-4.00	-7.00	-3.50

Mr. DASCHLE. Generally, what would you say about it? Is it a statement of fact that the basis was not as substantial on Friday as it was a week later?

Mr. CULVER. Normally that is one of the things that our surveillance personnel watch carefully. From the reports from surveillance, there were no unusual circumstances reported. Had those been out of line, they would certainly have been reported. While they may have changed, they were not—in the view of the various surveillance economists who were watching—out of line.

Mr. DASCHLE. I am almost out of time and I have an additional series of questions I wanted to ask.

Let me ask about the confidence in the future. If you can do so in a yes or no answer, would you say that there would be an increase in confidence, if the administration were to set out a diversion program for feed grains for the 1980 crop year? And, if so, would you say yes or no?

Mr. STONE. This is the kind of general agricultural policy question that I prefer to stay away from.

Mr. DASCHLE. That was not a yes or no answer. I can understand that. I am concerned that that volatility has not been eliminated. It is still there. The decisions that will be made in the next month or so can be greatly effected by knowing what impact the CFTC thinks those actions would have on the market, but projections of that kind are difficult. I can understand your reluctance.

Mr. JONES of Tennessee. Thank you, Mr. Daschle.

Chairman Stone, I have a question I would like to ask. I will give some time for the members to ask one more round of questions even though we have exceeded our time. I think this is an important meeting and since the whole Commission is here, we should use the opportunity.

I want to ask a question on silver. As you know, both exchanges which trade silver futures have taken action in recent weeks regarding the trading of silver. For the benefit of the subcommittee, will you describe the actions that have been taken by each exchange and tell us which approach you feel is the most successful of the two approaches that have been taken.

Mr. STONE. Why don't I first ask Dr. Culver to recite for you the dates and specifics of the actions. Or, rather, I think Mr. Manley has them right in front of him. Then I will comment on which we feel, as a policy matter, are most useful.

Mr. JONES of Tennessee. Mr. Manley.

Mr. MANLEY. Let me go through the two significant exchanges, that is, the Comex exchange in New York and the Chicago Board of Trade. On September 4, the Comex exchange took action to increase its price limits to allow silver to trade at higher prices. On October 8, they increased the price limits further and adopted a variable price limit, which I will explain to you if you need me to. In January the Comex exchange imposed position limits. They would limit the amount of contracts that an individual or a group of individuals acting in concert could hold. They also imposed reporting requirements, such that if someone had in excess of a certain number of contracts they had to report that fact to the exchange.

On January 21, the exchange imposed trading for liquidation only in all silver contract months. They also increased the margin significantly. The only other action that Comex has taken was that they made certain amendments to the liquidation only order.

Now, turning to the Chicago Board of Trade, the Chicago Board of Trade in September also increased its price limit. They also revised their spread limits, that is the amount spreads could trade at. On October 25, the Board of Trade imposed certain position limits. On January 22, 1980, they imposed trading for liquidation only in January, February, and March silver contracts. And on January 25, they amended the order I just mentioned to prevent day trading, that is, trading just for the day. Traders would have to have reduced their positions by the end of the day to the limits that were imposed January 22.

These are the two significant exchanges that are involved in silver trading.

Mr. JONES of Tennessee. Chairman Stone.

Mr. STONE. I think that is the complete list.

My General Counsel tells me that I should be very careful here, because there is a lawsuit currently in process about the appropriateness of some of the actions taken, and the Commission has its own legal obligations to review some of the actions. I will have to be somewhat guarded in my phrasing.

Let me say that I believe—and on this I think I speak for all the Commissioners—that we have seen since the March wheat case and in the last year or so a significant improvement in the responsiveness of exchanges to problems. We have seen exchanges take actions when that would have been less likely in the past. I can tell you that it is quite pleasing to us to see this responsiveness on the part of the exchanges.

With respect to the specific kinds of actions taken in silver, let me say, again on a somewhat philosophical plane to avoid getting into a problem with the pending litigation, that ordering trading for liquidation only is clearly an extreme measure. We hope we will not see that often in many markets. That is the kind of action that is to be taken only when a situation is perceived as quite serious.

Position limits, on the other hand, seem to me to raise some interesting open questions that we should all be considering in the future. One might ask whether the imposition of position limits is a good general way of seeing that we do not have the terrible kind of congestion and overconcentration in one side of the market that the Commission believed was occurring in silver. It caused us to indicate to the exchanges as strongly as we could, in informal ways, that we were going to watch them carefully and hope that they would consider action.

Mr. JONES of Tennessee. Thank you, Mr. Stone.

My second question, I guess, will go unanswered since you qualified your statement as you did. I was going to ask you what sort of grade you would give to the exchanges for the actions they had taken.

Mr. STONE. I do not think my General Counsel wants me to answer that.

Mr. GAINES. I think the papers are being corrected right now down at the Division of Trading and Markets. [Laughter.]

Mr. JONES of Tennessee. Thank you, gentlemen.

There are two members who have arrived since we began to give time for questions. I think we will recognize them before we go back around.

Mr. Harkin, do you have a question?

Mr. HARKIN. Thank you, Mr. Chairman. I have just a couple.

Mr. Stone, 3 or 4 years ago, when I first came on this subcommittee, we began to question why at that time there were only, I believe, two delivery points for corn, one being Chicago and I think the other one being Minneapolis. There was another delivery point established, if I am not mistaken, about 2 years ago in Toledo.

I thought it rather odd at that time that another delivery point would be established east of Chicago. I still think it is odd. In Iowa, where we raise most of that corn, eastern Nebraska, northern Missouri, eastern South Dakota, southern Minnesota, we find great spreads in basis, especially since the transportation situation is so bleak out there. From western Iowa to eastern Iowa we can have a spread of probably as much as 20 or 30 cents at any given time.

I wonder just what goes into your decision as to whether or not we need another delivery point, and if so, where the delivery point ought to be established. I still feel strongly that there ought to be another one west of the Mississippi somewhere. I am not dead set on where, but someplace west of the Mississippi, especially now. I feel that way even more so now than I did 2 or 3 years ago because of the current railroad situation.

Will you address yourself as to, one, what goes into whether or not you decide there will be another one, and two, where it should be located?

Mr. STONE. With respect to delivery points in corn, I think you have correctly stated that the current delivery points are Chicago, Toledo, and St. Louis. With respect to the factors that go into our decision, let me say that this is always a tough item for the Commission to evaluate, because there is a tradeoff. On one hand, more delivery points provide a good safety valve against congestion in a market, against an emergency transportation problem, or a warehouse space problem, and that pushes in the direction of more delivery points.

On the other hand, for the benefit of those people who trade on the markets, particularly on the buy side, the certainty of knowing where they are going to take delivery and the certainty of knowing that if they take delivery in a particular place, it will cost them some specific amount of money to get the grain to where they want it, contribute to wanting a smaller number of delivery points.

What we will have to do, therefore, in every case is to try to find some kind of judicious balance and it is necessarily a judgment call. What we would be strongly influenced by—as I tried to indicate was true in the recent grain restriction case—are the views of all of the market users. If we can find a situation in which market users, both on the buy and sell sides, can be brought together and can help to develop for us a proposal that helps the market as a whole, I think it would be safe to say that the Commission would be very strongly influenced by that. Where we have tougher prob-

lems are situations where sellers say one thing and buyers say another, and there we seek a judicious balance. The latter gave us the three delivery points we have now.

Maybe Dr. Culver would like to add to that if you need more detail.

Mr. HARKIN. I would like you to elaborate on the point of the certainty of delivery. What percent of contracts are delivered?

Mr. STONE. They are a very small percentage.

Mr. HARKIN. In certain times, let us say, when transportation becomes so congested, the farmers farthest away from the delivery points really get whipsawed because of it, and they have no control over it. They really do not have the knowledge of the situation that the traders do. The traders know how many rail cars there are. They know what is happening, while the farmers may not.

It would seem to me that a buyer who buys at the Chicago Board, who may be a cattle feeder in Texas, or may be an exporter in New Orleans, if they knew that the grain was delivered to Omaha or Kansas City, would be in every bit as good shape as if he knew for certain that it would be delivered in St. Louis or Chicago.

You said the down side of the question was the certainty of delivery points. If it were certain to be delivered in Omaha, if that were the delivery point stipulated in the contract, what difference would it make?

Mr. STONE. If you are talking about changing the delivery points—

Mr. HARKIN. I am not. I am talking about establishing another delivery point.

Mr. STONE. Any time you establish another delivery point, there will be some uncertainty about what the transportation costs will be, what the specific warehouse space will be in that place at that time. There is a little uncertainty added every time there is a new delivery point.

Mr. HARKIN. I disagree on that one point, because we know what the storage facilities are in any one of those areas. That could be ascertained in a matter of days. We have already ascertained it.

Mr. STONE. Those things are quite fluid. One of the things our surveillance staff pays the closest attention to and reports to us on every Friday is the market surveillance characteristics of a particular market, including whether the warehouse space that might be used for one thing is being used for another at that time or if there is some sort of transportation emergency. Those are fairly fluid conditions and they do change over time.

In any case, I do not mean to suggest that I am in any way closeminded or that the Commission would be closeminded to expanding the number of delivery points or changing them. I think we would want to hear from as many users of the market as possible that there is an important economic reason for making a change. I can assure you that we would listen very carefully when we hear from market users that there is such an important economic reason.

Mr. HARKIN. Excuse me, Mr. Culver. Did you want to add something?

Mr. CULVER. An aside comment is that the proposal for the delivery points comes in a proposed contract or proposed change in

a contract from the exchange and then we evaluate that proposal on the delivery points based on a number of factors—the facilities available, the transportation, et cetera.

There are trade-offs though in the number of delivery points, and as you get too many you do have pricing problems in determining the basis. It is much more difficult to determine when you have several delivery points. Another item I want to point out is that the tendency over the last few years has been to develop more delivery points in most of these commodities. I think that is a trend that will probably continue.

Mr. STONE. Congressman, I would like to add that we do have the authority on our own to order it. If we heard a very convincing case from market users in that regard, it is something we would very seriously consider.

Mr. CULVER. One final thing is that it will not take away the price differential to have a different delivery point. The price differentials will not vanish because you have more delivery points.

Mr. JONES of Tennessee. The time of the gentleman from Iowa has expired.

The Chair recognizes Mr. Huckaby.

Mr. HUCKABY. Thank you, Mr. Chairman.

Mr. Stone, if I were a speculator and wished to purchase a futures contract, what percentage of cash would I be required to put up?

Mr. STONE. That would vary from contract to contract. No one percentage is specified.

Mr. HUCKABY. Let us just say, wheat. Let us say I wanted to purchase a futures contract.

Mr. STONE. You would have to figure the percentages out every day. In dollars, I think we can get you the figures.

Mr. HUCKABY. Can you tell me approximately?

Mr. STONE. We can get you the dollar figure. You have to figure out the percentage based on the price at that time.

[The material supplied follows:]

Initial Speculative and Hedging Margin Requirements for Grain, Soybeans,
and Soybean Products on the Chicago Board of Trade as of February 12, 1980

Commodity	Price of March Future	Contract Size	Initial Speculative Margin		Hedging Margin	
			Margin Requirement*	Percent of Price	Margin Requirement*	Percent of Price
Wheat	\$ 4.56½ bu.	5000 bu.	\$1,250 (.25)	5.48%	\$1,000 (.20)	4.38%
Corn	\$ 2.74½ bu.	5000 bu.	\$ 600 (.12)	4.38%	\$ 500 (.10)	3.65%
Oats	\$ 1.49½ bu.	5000 bu.	\$ 400 (.08)	5.36%	\$ 300 (.06)	4.02%
Soybeans	\$ 6.67½ bu.	5000 bu.	\$1,500 (.30)	4.49%	\$1,000 (.20)	3.00%
Soybean Oil	\$.2396 lb.	60,000 lb.	\$ 750 (.0125)	5.22%	\$ 400 (.0067)	2.78%
Soybean Meal	\$181.60 ton	100 ton	\$ 750 (7.50)	4.13%	\$ 600 (6.00)	3.30%

* The margin requirements shown are per contract, with the requirement per pricing unit shown in parentheses.

Mr. HUCKABY. Will you also figure a price if I were a farmer and I wanted to make a legitimate hedge? They do vary considerably I believe.

Mr. STONE. Without going through all of the calculations right now, I can tell you that usually the grain margins run between 5 and 10 percent, for a speculator.

Mr. HUCKABY. You say, 5 to 10 percent. If I were placing a legitimate hedge, how much would it be? It is about 3 percent?

Mr. STONE. Yes, it is 3 percent or possibly a little higher.

Mr. HUCKABY. If I were a speculator and elected to invest in a stock on the New York Stock Exchange in the grain market, what percentage would I probably be required to put up?

Mr. STONE. Those change from time to time, but you are talking about something closer to 50 percent.

Mr. HUCKABY. I thought it was 65. It is 50 percent today, is it?

Mr. STONE. It is 50 now, I believe.

Mr. HUCKABY. My question is, has the Commission considered, with the very high leverage possible in the futures commodities market, what impact it would have if the percentage were changed significantly, if for instance, a family or a very small group of people took very strong positions in a given commodity with the intent of cornering it? What impact might that have on the farmer, considering the somewhat violent swings that we have? Have you examined this issue lately? I would like to hear your thoughts.

Mr. STONE. That is not something that is within our purview. As I am sure you know, the statute specifically says that the Commission does not under ordinary circumstances have margin authority, so that is not something that the Commission has carefully reviewed as part of its day-to-day functioning.

I can tell you that my own view is that any increase in margin is likely to decrease the volume of trading. Whether that is a good thing or not is a more complicated question.

Mr. HUCKABY. Are you suggesting that if the volume of trading decreased, the market prices would fall?

Mr. STONE. No; I am not suggesting that it would have any impact on prices. The studies that I am familiar with do not indicate that there is clear answer in any market to the question of whether or not prices would be affected by a change in the margin.

Mr. HUCKABY. If the margin requirement were significantly increased, would it deter someone from trying to influence the market?

Mr. STONE. I think it is generally my view that margins have an impact on all kinds of participants in the market, but perhaps more so on the smaller ones rather than on the larger ones. Those that might be in a position to do what you have asked about are those who are most able to meet margin calls, which is why I said earlier that there is an open question in my mind—raised in connection with silver—as to whether position limits, in a philosophical sense, may be a better approach to that kind of problem than higher margins.

Mr. HUCKABY. In other words, you personally would not be in favor of increasing margin requirements. Is that so?

Mr. STONE. No, I am not prepared to give you a definitive answer at this point on that, because there are so many considerations

that would have to be taken into account. Because it has not been in our purview, I have not looked at that as I would if it were within our purview.

Mr. HUCKABY. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Huckaby.

I believe everyone has had an opportunity to ask questions now, and the other witness, Mr. Carswell, is here and has been waiting some time to be heard, but I am going to give everyone another opportunity to question the Commission and I want to remind members of the subcommittee that all members of the Commission are here today, so if you prefer to ask them a question, you may do so.

I would like to ask the members of the subcommittee to confine their questions to only one per turn.

Mr. Glickman?

Mr. GLICKMAN. I would like to speak a moment about what Mr. Madigan was getting at. I think Members of Congress are concerned that the criteria may be loose for ordering the closing of markets. For example, the Government decides to change farm policy, you close the grain market again.

I realize that the statute is rather open. I do not want to get into a situation similar to the one Justice Clark got into, when they were talking about pornography and they asked him, "What is pornography?", and he said, "I cannot define it, but I know it when I see it." Similarly, when you think it is appropriate to close the markets, you need to have criteria that people in the outside will know about, so that they do not fear that every time the Government takes some sort of action, you will not know how to define it but will know when you see it.

I wonder if you will describe your criteria for the closing of markets.

Mr. STONE. The criterion that the Commission takes into account first and foremost is whether the market under the circumstances can be expected to accurately gauge supply and demand. If something has happened that causes the markets to be unable to do that—and I think that was the case in the recent grain situation—then we are likely to want to close the market.

Mr. GLICKMAN. To make the point clearer, you are talking about an extraordinary remedy that would be rarely if ever used. I want to make sure that since most actions the Government takes do effect the market in some way or another, and supply and demand is effected by that fact—

Mr. STONE. The standard is not an effect on supply and demand. It is an action which is so traumatic in impact that as a result the market is unable to even gauge supply and demand. That is quite different and is a higher standard.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

The Chair recognizes Mr. Madigan.

Mr. MADIGAN. If the Government decides to suspend the sale of 17 million metric tons of grain, the Commission makes a judgment on the basis of that governmental action the market is not able, to quote you, "To accurately gauge supply and demand." If that is so, my question would be, what would the Commission do if the Gov-

ernment announced the sale of 17 million metric tons of grain in Singapore and Malaysia tomorrow?

Mr. STONE. I cannot answer a question that hypothetical on behalf of the other Commissioners. We have not considered anything of that sort.

I can tell you that my own view is that there is a difference between an action similar to the one we saw about a month ago, in which there were several parts to the announcement, and an action which is announced all at once and which contains only one piece of news. What is important to understand about the situation last month is that the President made an announcement on Friday night and it was not until Tuesday that people knew what plans USDA was going to adopt to compensate. During that interval we believed—and I still believe—the market would have been unable to successfully gage supply and demand.

That is quite different from a situation in which a single announcement is made. But if the single announcement were traumatic enough, I am sure the Commission would have to talk about a suspension. I do not know what it would do in any specific case.

Mr. MADIGAN. I am unable to escape the conclusion that the Secretary of Agriculture asked you to close the market and you obliged his request. I cannot get away from that, and I am sorry you have not persuaded me that is not what happened.

Mr. JONES of Tennessee. Thank you, Mr. Madigan.

Mr. Baldus, do you have another question?

Mr. BALDUS. No, I do not.

Mr. JONES of Tennessee. Mr. Harkin, do you have any more questions?

Mr. HARKIN. Mr. Chairman, I only have one. I understand from reading your testimony that one of the things you are going to be looking into in the future has to do with the cattle futures market. I am sorry that I do not know if any one else brought that up this morning.

Mr. STONE. It has not been discussed this morning, but, yes, I did mention that in my statement.

Mr. HARKIN. You say you are going to be looking into it. Will you elaborate on that a bit for me? I would like to know just what you are going to be looking at in terms of the cattle futures market.

Mr. STONE. Specifically, we are looking at some past actions and trading behavior in the cattle market. In particular, we are looking to see whether there was any improper or illegal activity in the futures markets with respect to August cattle of last year.

Mr. Culver can give you more detail if you want it. It is a bit sensitive since it is in the investigation stage, and I do not think you would want us to talk about who we would be investigating when we have not brought any specific charges.

Mr. HARKIN. I see. I really do not want to go into that. A lot of cattle dealers in my area have mentioned to me often that something is awry in the cattle futures market. That is their feeling.

Mr. STONE. We have some concerns and there is a current investigation in process now. It is important to understand, with respect to that, that the concerns extend beyond the futures markets and that we are therefore working closely with USDA. We are trying to

coordinate an effort by which we look primarily at the futures market and they look primarily at the cash markets and we share data along the way, because most of the allegations we have heard about wrongdoings in the cattle market do involve both cash and futures. So, we feel it is important to work with USDA.

Mr. HARKIN. This subcommittee heard testimony not too long ago from my colleague from Iowa, Mr. Smith, on the electronic trading option and of moving in that direction for cattle futures. I assume that you will be looking into that possibility too, that is, of establishing electronic cattle—

Mr. STONE. Congressman Hance mentioned that earlier and suggested some preconditions he felt would have to be met before there could be a successful system. Because that is primarily a cash market system, I do not think you could expect us to be taking the lead in forcing or interfering in any way in the development of such a system. It is primarily cash and not futures.

Mr. HARKIN. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Harkin.

Mr. HUCKABY, do you have any more questions?

Mr. HUCKABY. No, sir.

Mr. JONES of Tennessee. We have received a notice that we will have to go to the floor of the House.

Mr. Stone, I have one question that I would like to ask very quickly. The 1978 act requires the CFTC to coordinate with the Treasury, the SEC, and the Federal Reserve on issues that are of mutual interest. Now, occasionally you see in the press reports of certain disagreements between CFTC and these other agencies. Would you care to describe what formal coordination procedures have been instituted and then how they have been working out?

Mr. STONE. Yes, sir.

Mr. JONES of Tennessee. And if any improvements can be made.

Mr. STONE. Yes, sir. I think that coordination between these agencies is extremely important. I know that the desire of the Commission is to have a great deal of information exchange and opinion exchange between the concerned agencies.

That is handled primarily in a formal manner through an inter-agency committee that has been established. Commissioner Dunn has served extremely ably as our representative on that committee. In addition, these are representatives of the Federal Reserve, representatives of the Treasury and representatives of the SEC on that interagency task force.

There have been a number of formal meetings at which ideas have been exchanged and there has been an even greater volume of informal contact. We have encouraged that both at the Commission level and at the staff level. The staff, for example, in the area of monitoring financial futures, maintains through Mr. Culver's staff in surveillance constant contact with the New York Federal Reserve, which does much of the surveillance work for the Federal Reserve System.

I think it would be safe to say that at all levels—the Commission level and the staff level—we have taken very seriously the requirement for coordination and we think we have benefited from it. We think it is valuable.

Mr. JONES of Tennessee. Thank you, Chairman Stone.

Does anyone else have another quick question for the Commission?

If not, gentlemen, we do appreciate very much your being here. I think you have contributed to the subcommittee's need for information, and we do appreciate the cooperation that you have given us. Thank you very much.

Mr. STONE. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Gentlemen, let me ask you this. In view of the fact that the House will be going into session in about 8 minutes, and Mr. Carswell is here, should we hear his statement now? Keep in mind that we will be having about six straight votes on the floor today, I suppose, fairly soon after we get over there. Should we ask Mr. Carswell to be the lead witness at 1:30 or 2?

Mr. BALDUS. It is possible, Mr. Chairman, that we could go on successive 1-minutes over there, so that we could hear the statement now even before.

Mr. JONES of Tennessee. Do you want to hear him now?

Mr. BALDUS. Of course, it is up to you, but we may get interrupted or we may not.

Mr. JONES of Tennessee. We have to find out from him what his situation is too. I have not asked him. I have no problem with going ahead, if you think we can come back.

Mr. GLICKMAN. Mr. Chairman, I think we are going to have a series of votes, at least four. We can start and then see if he can come back around 1:30 or 2 to finish, because he has some very important testimony.

Mr. JONES of Tennessee. Mr. Carswell, we are sorry that we have delayed you as long as we have, but we have had the Commission here, as you quite well know, and it is very important that they be heard in detail.

This is Mr. Robert Carswell, Deputy Secretary of the U.S. Treasury. We are delighted you are here. Do you have anyone with you?

Mr. CARSWELL. I have John Schmidt and—

Mr. JONES of Tennessee. Bring them to the table if you would like, sir.

Mr. CARSWELL. I do not think it will be necessary.

Mr. JONES of Tennessee. All right. You may proceed.

STATEMENT OF ROBERT CARSWELL, DEPUTY SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Mr. CARSWELL. Mr. Chairman and members of this distinguished subcommittee, I welcome this opportunity to discuss with you the role of the Treasury Department under the Futures Trading Act of 1978 (Public Law 95-405, September 30, 1978.)

Your subcommittee's hearings came at a particularly appropriate time. During the last several months trading levels in all securities markets—and particularly in futures markets—have reached all-time highs. Both anecdotal evidence and the volatile prices in many of these markets indicate an increasing level of speculative activity. These developments have placed a heavy and increasing burden on the Commodity Futures Trading Commission and its statutory responsibilities for governance.

The Department of the Treasury has worked closely with the CFTC with respect to a portion of its responsibilities, namely, the

markets for futures contracts based on U.S. Government securities. These markets have quickly become the largest trading markets in the world, and they have major impacts on all other financial markets since Government securities serve as a price basis for all other debt securities.

The 1978 act provides that:

The Commission shall maintain communications with the Department of the Treasury, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission for the purpose of keeping such agencies fully informed of Commission activities that relate to the responsibilities of those agencies * * *

It further provides that the Commission shall solicit the views of the Department of the Treasury and the Board of Governors of the Federal Reserve System:

* * * when a board of trade applies for designation as a contract market involving transactions for future delivery of any security issued or guaranteed by the United States or any agency thereof * * *

And that—

the Commission shall take into consideration all comments it receives and shall consider the effect that any such designation, suspension, revocation or emergency action may have on the debt financing requirements of the U.S. Government and the continued efficiency and integrity of the underlying market for Government securities.

As we indicated to this committee in the spring of 1978, the Treasury is primarily concerned with the potential impact of financial futures on the Treasury's debt management flexibility and on the underlying cash market in Government securities. The continued stability, efficiency, and integrity of the Government securities markets are essential to the efficient management of the public debt, to the Nation's economic health, and to the effective functioning of all financial markets. Our overriding concerns remain unchanged. Indeed, the current period of record high interest rates and market volatility requires even greater attention to potential problems in the area of financial futures.

The growth of trading in futures contracts based on Treasury securities has been explosive. It has far exceeded expectations when such trading commenced in January 1976. The annual trading volume in Treasury bill futures contracts alone was about \$2 trillion in 1979, compared to \$769 billion in 1978, \$322 billion in 1977 and only \$110 billion in 1976. Before that there was none. Currently, the dollar amount of trading in the Treasury bill futures market actually exceeds the total volume of dealer trading in the cash market for Treasury bills. In view of the pivotal role of the Treasury bill market as a benchmark for other money market rates, this growth has major implications for the efficient financing of our economy.

It is important that the subcommittee realize that this explosive growth in futures has created great uncertainties, has compounded the problems of an already overburdened regulatory structure and has happened so quickly that the full significance is not yet known. We know little about who is participating in these markets, what they are doing or why or what economic purpose is being served. We are also concerned about the extent to which excessive speculation may be contributing to market instability and the extent to

which futures trading may be used solely for the purpose of minimizing Federal income tax payments.

Given our responsibilities under the 1978 act, yet lacking a body of research on which opinions could be firmly grounded, our first action under the new law was to propose to the Commission an immediate Treasury/Federal Reserve Board study of the markets in Treasury futures and a moratorium on new futures contract designations pending completion of the study. The Commission recognized the need for such a study and did not designate new contract markets in Treasury securities until the study was completed in May 1979. The Treasury benefited greatly from extensive briefings by the Commission and assistance by the Commission's staff in carrying out the study.

Our study focused on the following: One, the impact of futures trading on the efficiency and integrity of the cash market; two, the adequacy of deliverable supplies and the possible constraints on debt management flexibility; three, the ability of the exchanges and the CFTC to maintain effective surveillance, particularly in the cases of duplicative contracts; and four, the dangers for unsophisticated investors who may not fully appreciate the risks inherent in futures contracts when those contracts are based on USG securities.

As part of the study we sought the opinions of those who were favorable to futures markets and those who were unfavorable. Those who were favorable—generally the majority—argued that there were important social benefits from these markets and these benefits are discussed at length in the study. Our primary concern, naturally, was to identify potential problems and to determine how futures may affect the basic cash market for Treasury securities and the efficiency with which the cash market can accommodate the requirements of financing the public debt.

The study proposed guidelines for evaluation of futures contract applications. These addressed three principal issues: One, the adequacy of deliverable supply for existing and proposed contracts; two, the risks of a rapid proliferation of contracts and exchanges; and three, additional safeguards for investors.

For new contracts we recommend that the CFTC consider both the width of the maturity range of deliverable securities and the number of outstanding issues in determining the adequacy of deliverable supply. We recommended that the CFTC not approve a contract which depends solely on the deliverable supply of a single security yet to be issued and not designate new contracts which duplicate contracts on other exchanges. We also encouraged the CFTC to proceed gradually in authorizing new contracts, so as to minimize any perverse effects of rapid growth. These recommendations have been generally adopted by the Commission, except that the Commission did not feel it could adopt our recommendations to proceed gradually in authorizing new contracts. The study also urged that investor safeguards be adopted, including customer suitability and the use of serial tapes by the exchanges, and much remains to be done in this area.

The study recommendations caused changes to be made in four contracts that were pending Commission designation: An Amex Commodities Exchange, Inc., proposal to trade a contract for future

delivery on 90-day U.S. Treasury bills, a 90-day Treasury bill proposal from Commodity Exchange, Inc., a proposal submitted by the Chicago Mercantile Exchange to trade a 4-year Treasury note contract and a proposal for a 4- to 6-year Treasury note contract submitted by the Chicago Board of Trade. Moreover, the Commission has adopted many of our suggested guidelines for reviewing additional contracts.

In addition to providing comments in June 1979 on the four contracts noted above, we commented on the Amex Commodity Exchange 20-year U.S. Treasury Bond Contract on August 23, 1979, and on the New York Futures Exchange, Inc., proposal for futures contracts in 90-day Treasury bills and 20-year Treasury bonds on October 17, 1979. Copies of these communications are attached for the subcommittee's review.

Finally, at the request of the CFTC, the Treasury has reviewed the recently proposed contract for stock index futures. In our response to the CFTC, a copy of which is attached, we again raised our ongoing concerns about investor suitability, margins and market surveillance.

The Treasury and the CFTC have established a good working relationship in implementing the 1978 act and this has contributed to increased understanding and more effective development of futures markets in Government securities. However, our concerns with these markets have not diminished and we question whether the present regulatory structure is able to cope with all potential problems. Having approved trading in 13 financial futures contracts, the CFTC is now required to supervise a highly sophisticated and complex market that reached a trading volume of about \$2 trillion in 1979 but which did not exist 4 years ago. It has assumed these essentially new duties and at the same time it must deal with extraordinary trading and market situations in a number of other commodities markets. We would suggest that the subcommittee consider whether CFTC's resources are adequate for its expanded assignment and for the resolution of existing and potential problems in the markets it oversees. In the area of Treasury futures there are a number of unresolved issues that I would like to comment on.

As shown in the list attached to my statement, we now have 13 financial futures contracts being traded and 10 additional contracts under review by the Commission. This sudden surge in financial futures raise questions of proliferation and duplicative contracts. Many of the newer contracts have not been successful. Yet there seems to be no slowing of the new proposals. We believe that exchange self-regulation could weaken as each exchange seeks to promote its product. We are also concerned with the growing demands on the regulatory structure from such proliferation, particularly in view of the recent extraordinary actions which the CFTC was required to take to maintain orderly conditions in commodity futures markets.

Despite the recent proliferation of new contracts, three contracts continue to dominate activity in financial futures: The IMM 90-day bill contract and the Chicago Board of Trade Ginnie Mae and Treasury bond contracts. The volume of trading in the 90-day bill contract now actually exceeds the volume of dealer trading in the

cash market itself. The chart attached to my statement shows the trading volume and open interest in the T-bill contract from its inception and shows that the trading volume in the fourth quarter of 1979 was in excess of \$600 billion.

The second area of concern is the deliverable supply problem and possible pressures on the Treasury to relieve or prevent a squeeze in the cash market. The second chart attached to my statement highlights the growing problem of deliveries on the Treasury bill contract. As this chart shows, deliveries reached roughly half of the available supply for the December 1979 bill contract. Such pressures on deliverable supplies were a concern to many market observers in June and December because of abnormal price relationships among the underlying cash market bills. Specifically, the deliverable bill traded out of line with surrounding maturities.

You will recall that Congressman Harkin was pointing out that in the commodity futures area, the deliverable supply is below 10 percent normally. These deliveries were about 50 percent, so we obviously have market relationships here that really are not comparable to the commodities area, and we do not really understand what the right relationships are in this area.

These developments are difficult to quantify and assess, but they increase concern about the possibility of manipulative or fraudulent behavior as well as the likelihood of disruptive effects on the market for U.S. Government securities.

In the market practices area we are concerned with the complexity of contracts, the nature of participants in the market—the March 1979 survey by the CFTC indicates nearly half of the outstanding contracts are held by individuals and commodity pools—and the possibility that these markets may be increasing risk exposure rather than reducing it, even by professional participants, such as banks and financial institutions. We hope the CFTC will address some of these difficult matters, including margin rules, market surveillance, and various aspects of customer protection and suitability.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Carswell. It was a very constructive statement.

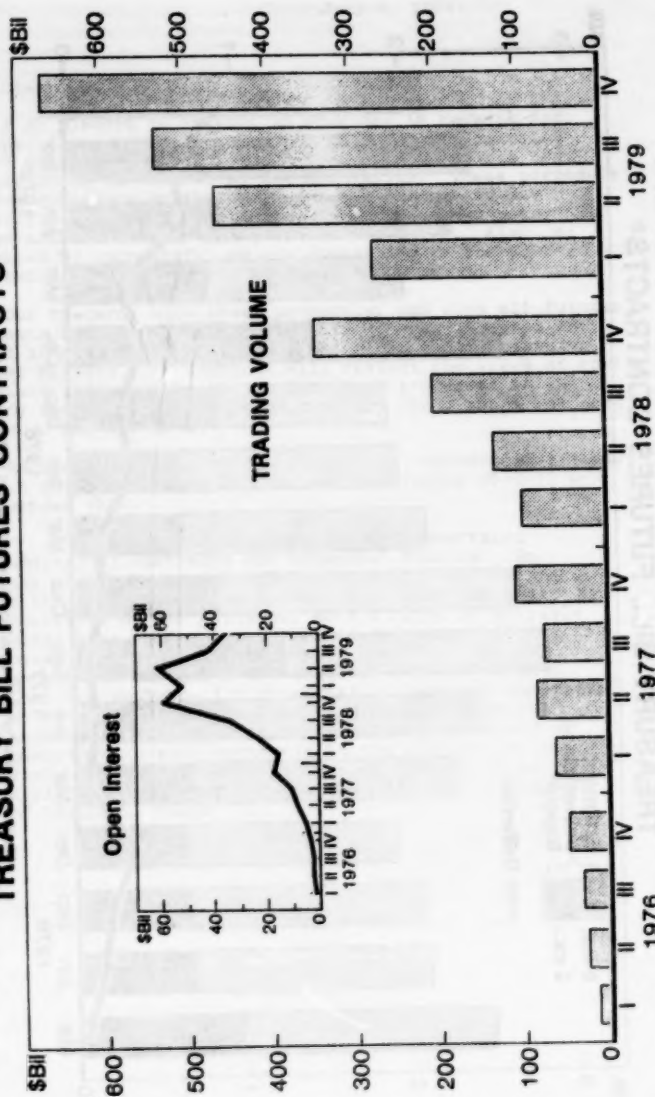
The graphs, charts, and lists that you presented will, without objection, be included in the record at this point.

[The material referred to above follows:]

Financial Futures

<u>Contract</u>	<u>Exchange</u>
GNMA (CDR)	CBT (since 10/75)
90-day T-bills	CME (since 1/76)
Treasury bonds (15-yr.)	CBT (since 8/77)
90-day commercial paper	CBT (since 9/77)
GNMA certificates	ACE (since 8/78)
1-year T-bills	CME (since 9/78)
GNMA certificates	CBT (since 11/78)
30-day commercial paper	CBT (since 5/79)
90-day T-bills	ACE (since 6/79)
4-6 year T-notes	CME (since 7/79)
90-day T-bills	Comex (since 10/79)
Treasury bonds (20-yr.)	ACE (since 11/79)
GNMA	Comex (since 11/79)
2-year T-notes	Comex (pending)
90-day T-bills	NYFE (pending)
Treasury bonds	NYFE (pending)
Short-term T-notes	CBT (pending)
Long-term T-notes	CBT (pending)
5-7 year T-notes	ACE (pending)
Certificate of Deposit	ACE (pending)
Domestic CD	CBT (pending)
Eurodollar CD	CBT (pending)
1-year bill	Comex (pending)

TRADING VOLUME AND OPEN INTEREST IN 90 DAY TREASURY BILL FUTURES CONTRACTS^{1/}

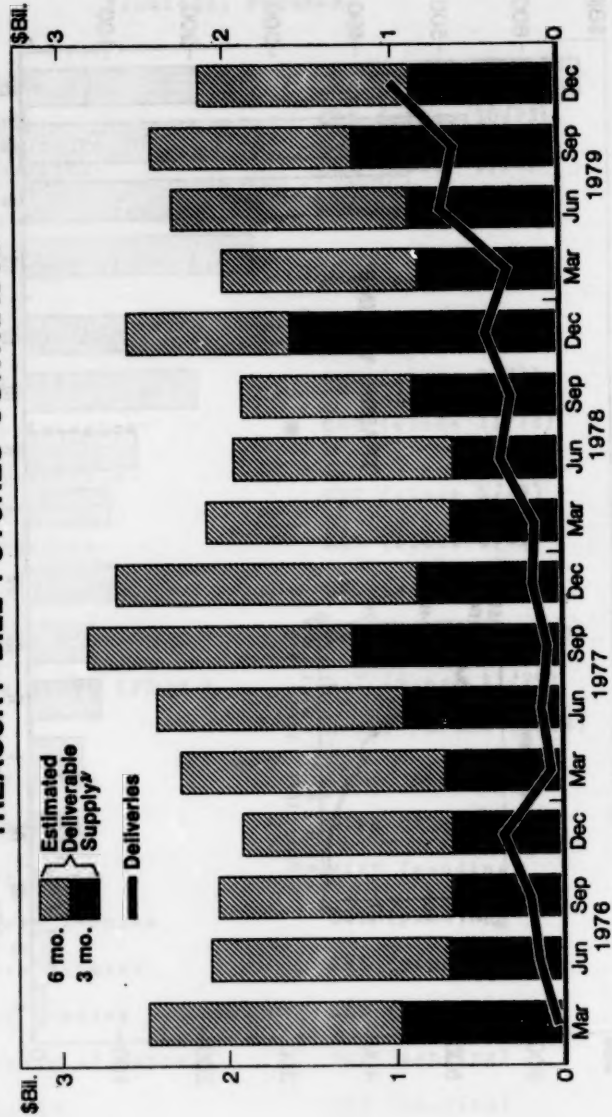


^{1/}Contracts traded on the International Monetary Market (IMM)

Office of the Secretary of the Treasury
Division of Government Financing

January 26, 1980

DELIVERABLE BILLS AND DELIVERIES ON 90 DAY TREASURY BILL FUTURES CONTRACTS^{1/}



^{1/} Contracts traded on the International Monetary Market (IMM)
^{2/} Consists of the amount of accepted competitive tenders for the new
 3 month bill and the 6 month bill issued 3 months earlier.

June 6, 1979

Dear Chairman Stone:

I am pleased to respond to your May 15 request for our specific comments on three of the proposed contract market designations for financial futures contracts that are now being considered by the Commission. These proposals involve contracts on the Comex and the Amex in 90-day Treasury bills and on the CME in Treasury 4-year notes (notes with 3-3/4 to 4-1/4 years to maturity). Also, as requested by your staff, we are commenting on the CBOT's proposed contract in 4-6 year Treasury notes.

Our concerns with these proposals, and with all futures contracts based on Treasury securities, are discussed in detail in the Treasury-Federal Reserve Study of Treasury Futures Markets. My comments will reflect the views of most immediate relevance to the applications expressed in the Summary and Recommendations part of the study which was sent to you on May 14, 1979.

In the discussion of the risks from contract proliferation in our Summary and Recommendations (pages 30-33), we recommended that:

--The CFTC proceed gradually in authorizing additional contracts for financial futures. In the untested intermediate-term sector, for example, a first step might be to authorize only one note contract, on one exchange, with a range of eligible maturities sufficient to provide a reasonable "market-basket" of deliverable supply. Further, the CFTC should not designate new contract markets on more than one exchange for essentially identical contracts unless it has reached formal agreements with the exchanges involved to provide uniform reporting of positions in such contracts to the CFTC and to establish uniform emergency procedures that would be implemented jointly and coincidentally at the request of the CFTC. (page 30)

Thus, the Study attaches great importance, in instances where overlapping markets are designated, to the active surveillance by the Commission of consolidated position reports of persons trading essentially identical contracts on more than one exchange and on the ability of the Commission to require the implementation of identical emergency procedures on such exchanges with respect to such contracts when necessary.

The Comex 90-day Treasury bill proposal specifies that "trading shall be conducted for delivery in every current calendar month and the two immediately following calendar months" (Rule 3). In addition, the proposal states that "trading... shall terminate on the second business day following the third regularly scheduled 3-month Treasury bill auction occurring in such delivery month" (Rule 4). With these provisions, the proposed contract would duplicate the currently existing CME 90-day contract. Thus, the proposal raises the question of competition for deliverable supply, as discussed on pages 31-32 of our Summary and Recommendations.

The proposed Amex 90-day Treasury bill contract market designation specifies that "trading in Treasury bills may be conducted during such months as may be determined by the Board (January, April, July, October)" (Rule 1004). The proposal also states that "trading shall terminate on the Wednesday following the third Monday of the contract month" (Rule 1010). Since the CME's 90-day contract market designation also specifies that trading may be conducted during such months as may be determined by the Board and also specifies the third auction of the month as the basis for delivery, the Amex proposal also could result in duplicative contracts even though the exchanges apparently intend to trade different delivery months.

We recommend, therefore, that the Comex and Amex 90-day Treasury bill proposals not be approved by the Commission unless the potential duplication discussed above is eliminated. We understand that the CFTC is currently considering modifications to these proposals which would be responsive to the recommendations in the Treasury-Federal Reserve Study, including the recommendations with respect to the collection of cash data by the CFTC and uniform reporting and emergency procedures by the exchange. We would be happy to review the revised proposals.

With regard to the note proposals, as noted above, the Treasury-Federal Reserve Study recommends that the CFTC proceed gradually in authorizing additional contracts for financial futures. This is particularly true in the untested intermediate-term sector, especially since the characteristics of Treasury notes differ considerably from Treasury bills and bonds. In the case of Treasury bills, their money market nature makes them very liquid and generally available. Bonds are highly substitutable because the yield curve is relatively flat in the long-term sector. In the intermediate area, however, the shape of the yield curve is more variable. Thus, it would be propitious to move slowly in the initiation of futures trading in the note area, and the Study recommends that a first step might be to authorize only one contract, on one exchange.

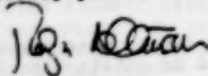
The CME 4-year note proposal calls for trading in futures based on outstanding Treasury notes that will have between three years, nine months and four years, three months remaining to maturity at the delivery date (Rule 3704). Our four recommendations concerning the adequacy of deliverable supply on page 22 of the Summary and Recommendations are relevant to this proposal. Your attention is drawn particularly to the statement that approval should be withheld on contracts which specify a relatively narrow maturity range for the deliverable supply "if the deliverable supply of already outstanding maturities consists of only small amounts of closely-held issues." It would be possible under the CME note proposal for new contract months to begin trading when there are no outstanding securities potentially eligible for delivery or when there is only a small amount of closely-held issues available for delivery.

The CBOT 4 to 6 year note proposal calls for trading in futures on Treasury notes and non-callable Treasury bonds which have a maturity of not less than four years and not more than six years (Rule 9151). Thus, this contract partially overlaps the CME 4-year note proposal, and our recommendation cited above regarding proliferation also applies here. Moreover, at the time this proposal was submitted in July 1978, the Treasury had been issuing 5-year notes on a regular basis, but we have not issued a 5-year note since April 1978. Therefore, the deliverable supply for this contract is more likely to consist only of seasoned, and possibly closely-held securities.

In light of the above considerations we recommend against approval of the CME and the CBOT note contracts unless the CME contract is modified to specify a broader range of maturities for the deliverable supply, and unless formal agreements have been reached with respect to uniform reporting and uniform emergency procedures in accordance with the recommendation cited above.

Thank you for this further opportunity to comment on these proposals. We appreciate the careful consideration that you have given to our recommendations, and we look forward to working with you.

Sincerely yours,



Roger C. Altman
Assistant Secretary

The Honorable
James M. Stone
Chairman
Commodity Futures Trading
Commission
2033 K Street, N.W.
Washington, D.C. 20581



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY

WASHINGTON, DC 20220

August 23, 1979

Dear Chairman Stone:

I am pleased to respond to the Commission's request for comment on the Amex Commodities Exchange proposed 20-year U.S. Treasury Bond Futures Contract.

The May 1979 Treasury/Federal Reserve Study of Treasury futures markets points out that overlapping futures contracts pose special problems since the deliverable supplies of such contracts may be drawn from the same pool of securities. The Study also indicates that the proliferation of contracts will likely lead to enlarged total demands for delivery, which in turn could have adverse effects on the Treasury securities market.

Although the proposed ACE contract differs in many ways from the existing Chicago Board of Trade bond contract, it overlaps that contract in its source of deliverable Treasury bonds. Therefore, it presents special problems in the areas of surveillance and emergency procedures, as discussed in the Study.

We recognize, however, that potential deliverable supply problems are greatly reduced in this case because of the relatively large market-basket of securities eligible for delivery under either contract. Delivery problems should be further reduced by the provision in the ACE contract for quarterly delivery months which would not overlap the CBOT delivery months.

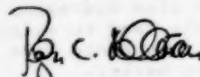
The ACE contract calls for delivery on a single date of the delivery month, whereas the CBOT contract allows for delivery throughout the delivery month. This raises the question whether multiple-day delivery or single-day delivery would exert more pressure on the available deliverable supply. Our preliminary analysis of the limited data available on delivery experience in 1978 with the Treasury

bond contract and the GNMA contract indicates that deliveries were generally concentrated at the end of the delivery period with the notable exception of the December contract, in which deliveries occurred early in the month thus increasing the potential for redeliveries of the same securities. Further experience and analysis are necessary to determine the volume of actual redeliveries and their impact on deliverable supply. Accordingly, we recommend that the CFTC examine the relative merits of single-day versus multiple-day delivery and retain the flexibility to require changes in the delivery period, if appropriate, to minimize pressure on the deliverable supply.

If the CFTC should decide to approve the proposed contract, we also recommend that the exchanges be required to agree to procedures for dealing with emergencies which will help to assure that competition between the exchanges will not result in a deterioration in standards.

I hope these comments are helpful to the Commission.

Sincerely yours,



Roger C. Altman
Assistant Secretary

The Honorable
James M. Stone
Chairman
Commodity Futures Trading
Commission
2033 K Street, NW
Washington, DC 20581

OCT 17 1979

Dear Chairman Stone:

This letter responds to your July 27, 1979 communication requesting comments on the New York Futures Exchange, Inc. proposals for futures contracts in 90-day Treasury bills and 29-year Treasury bonds.

These proposals raise questions regarding the potential risks of contract proliferation and the possibility of enlarged total demands for delivery. As indicated in the May 1979 Treasury/Federal Reserve Study of Treasury Futures Markets, overlapping contracts on more than one exchange may create deliverable supply problems and for this reason duplicative contracts should be avoided where possible. We are also concerned with the demands being placed on the cash market from the unabated growth in deliveries on existing contracts. A continued growth in demands on individual issues may lead to price distortions in the cash market for Treasury debt.

The New York Futures Exchange 90-day bill contract specifies that delivery will take place in October, January, April and July (Rule 804) and that delivery will entail the third bill auctioned in the delivery month. Currently the Amex Commodities Exchange trades 90-day bills for delivery in the third week of the same delivery months specified by the New York Futures Exchange. Furthermore, two other exchanges now trade the third bill in different monthly cycles. The Commission should resolve the overlap problem before approving this contract. Consideration should be given to the problem of growing demand pressures on individual bills and potential spillover effects on neighboring bills. The problems may be resolved by replacing a single deliverable issue with a market basket of deliverable bills. It is our understanding that some industry participants advocate such an approach. However, any such market basket

would need to be structured carefully to avoid technical problems, and undue pressure on particular bills. Any market basket proposed, must strike a proper balance between a broad enough basket and an acceptable hedging instrument. Before approving this contract the Commission should examine the merits of single issue delivery versus market baskets for Treasury bills.

The New York Futures Exchange 20-year bond proposal is for the most part identical to the Amex Commodities Exchange 20-year bond contract. Our views with respect to that contract were detailed in our letter of August 23, 1979. In that letter we indicated that overlapping futures contracts pose special problems in the areas of surveillance and emergency procedures, which were discussed at length in the Study.

The New York Futures Exchange bond proposal does not specify the months traded (Rule 824). We recommend that the contract delivery months be specified to differ from those on the Chicago Board of Trade bond contract and the Amex bond contract in order to minimize deliverable supply pressure and the special surveillance difficulties of duplicative contracts.

The New York Futures Exchange contract calls for single day delivery. Our letter of August 23, 1979 recommended that the CFTC examine the relative merits of single-day versus multiple-day delivery. We further urge the Commission to examine this issue to determine which delivery procedure minimizes pressures on the deliverable supply. We also recommend that the exchanges be required to agree to essentially similar procedures for dealing with emergencies.

Sincerely yours,

/s/ Roger C. Altman

Roger C. Altman
Assistant Secretary

The Honorable
James M. Stone, Chairman
Commodity Futures Trading
Commission
2033 R Street, N.W.
Washington, D.C. 20561



THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

February 11, 1980

Dear Mr. Manley:

I am pleased to respond to your letter of December 4, 1979 requesting comments by the Department of the Treasury on the proposal made by the Kansas City Board of Trade (KCBT) to market a futures contract based on the Value Line Average (VLA). We note that this proposal and the associated documentation demonstrate that the KCBT has expended considerable effort to improve its initial proposal in 1978. In particular, the shift to the more broadly based Value Line Average provides a measure of total stock market movement superior to the earlier proposal.

As we noted in our letter of November 9, 1978, we support developments that promote the efficiency of the nation's capital markets while providing effective protection of investors and minimizing the chance of market disruptions. Since our 1978 communication with the Commission, the marketplace and regulatory agencies have learned considerably more about financial futures. For example, in May 1979, the Federal Reserve/ Treasury study was completed, which included extensive interviews with market participants. Some of the concerns expressed in our earlier letter have been assuaged by experience and continued analysis of the issues involved. But other concerns still linger and, indeed, are reinforced by the press of events. Moreover, many now believe that approval of a stock index future will lead quickly to pressure for futures on narrow sectoral indices and individual stocks. Thus certain regulatory matters, particularly the authority to establish and adjust margins and the erection of adequate investor protection safeguards, should be settled prior to approval of even an index future. Therefore, although the specific KCBT proposal represents an improvement over its earlier submission, there remain important problems which need to be resolved before we would be satisfied by approval of the contract, particularly since this contract may attract substantial participation by individual investors.

Suitability and Other Customer Protection

First among our concerns is the likelihood that a stock index future such as the proposed VLA contract will be inappropriately merchandised by brokerage firms and improperly used by investors who do not fully understand these contracts. We envision the possibility that the stock index future could become, in these times of heightened speculative tendencies,

a popular means for the uninformed to "bet" on the future course of stock prices. Clearly, if the contract gained broad public acceptance, the risk component of household portfolios would be increased greatly, but not necessarily with the appropriate appreciation of the potential consequences.

On equity grounds, and because well-publicized losses to small investors "taken for a ride" could potentially disrupt markets, various organizations have advocated customer suitability requirements for futures and/or options trading. The NASD, of course, requires its members to "know your customer" (both to protect the NASD member and the customer). Beyond that the SEC in 1967 adopted its own requirement for non-NASD dealers which imposes on securities firms an "affirmative duty" to inquire as to suitability to a particular transaction for a customer. The CBOE, when it began operations in 1973, adopted a rule similar to the SEC "affirmative duty" requirement. The joint Fed/Treasury study on financial futures in 1979 called for "further study of investor protection". And the SEC Options Study recommended that the broker/dealer be required to "find that the customer is capable of evaluating the risks" of options trading.

In response to the concern over adequate disclosure and customer suitability, the KCBT states that various "measures will be instituted to preclude the participation of the unknowing and the unwary". However, the KCBT proposal is not specific in defining these "measures". Indeed, while the KCBT rules require each FCM to have a written customer suitability program, no uniform minimum standards are specified. The eagerness to stimulate activity in stock futures is an incentive to minimize investor safeguards. Moreover, the competition between stock futures and stock options may lead to a "competition in laxity" with respect to those safeguards. Thus, it is important to have appropriate investor protection provisions in place prior to the designation of any stock futures contract. It should also be clear that the KCBT has the capability to enforce such protections, and that the CFTC has adequate authority and resources for discharging its oversight responsibilities.

Treasury also favors a more explicit and elaborate risk disclosure statement than that now required by CFTC's Rule 1.55. For example, in addition to the statement that "the risk of loss in trading future contracts can be substantial" and that the participant "... may sustain a total loss of ... initial margin funds ...", the statement might identify the percentage variation of a contract's price, or that of the underlying index, which would produce a loss of initial

margin. The disclosure statement should also discuss the characteristics of the index and its historical behavior in different types of market environment, the nature of companies included in a narrow sectoral index, and the risk magnification effect of leverage. Also, data are available about the percentage of "nonprofessional" participants who typically lose on commodities futures trades and such data might be included in the disclosure to underline the message and enhance its educational value.

Proliferation of Contracts

The well-documented growth of futures and options attests to the instruments' marketability and broad acceptance. Whether or not the KCBT stock index proposal becomes a success, other exchanges are likely to follow suit with variations on the stock index future. Thus, our second concern is that this new market sector may burgeon far more rapidly than the resources of the Commission and the exchanges, leading to the possibility that oversight and surveillance capabilities will become strained if not insufficient.

Multiple exchanges dealing in various stock index futures and/or multiple listings of the same future on several exchanges are not onerous per se. Presumably, the most efficient quantity, quality and distribution of stock index futures contracts will be determined ultimately by the marketplace, with some contracts and even some exchanges falling by the wayside. However, during this playing out of the competitive process, proliferation will necessarily place new and difficult burdens on the surveillance staffs of the individual exchanges and on the oversight/surveillance resources of the Commission. We are especially concerned that minimum, uniform reporting standards be applied to the various exchanges and/or contracts so that manipulative practices could not be carried out on multiple exchanges to avoid detection.

Margin requirements

The size of the initial and maintenance margins on stock futures influences futures' competitive position vis-a-vis options. Of course, exchange-traded options exist only for some individual stocks; and the stock index future would not be in direct competition with the options market. However, if the CFTC approves individual stock futures on one or more stocks currently traded on the options market, either the stock future or the stock option might initially dominate the other, depending on a variety of factors. These factors include: the option price (premium), the size

of the initial futures margin, the futures contract price, and options buyers' preference for limited down-side risk. Indeed it is evident that futures exchanges, in the current regulatory framework, could reduce margin requirements on individual stock futures low enough to obtain a competitive advantage over the options market (i.e., a sufficiently low margin requirement could always cause futures contracts to dominate options purchases -- except for those investors who wished to limit down-side risk to the loss of the option premium).

In addition, margin requirements also serve a customer suitability and protection function. An appropriately high margin requirement would screen out certain investors whose sophistication and resources make them unsuitable customers for stock index and individual stock futures.

At present, apparently neither the CFTC nor any other agency has clear authority to establish and adjust margins for approved contracts, and thus could not stop ambitious futures exchanges from setting initial margins very low or even at zero (while still requiring daily, after the fact, marking-to-market). At a minimum, regulatory authority in this area should be specifically clarified or established. Obviously, there must be coordination among the CFTC, SEC and Fed to monitor competitive inequities as between stocks, stock options, and stock futures, brought on by margin regulation. It is our view that this aspect of the stock futures question should be resolved, through new legislation if necessary, before approval of any stock futures contracts.

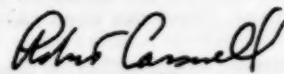
Stock eligibility requirements.

To minimize the chances of corners or squeezes occurring, the Commission should consider eligibility standards for individual stocks traded under futures contracts. These would be intended to assure that the depth and liquidity of the spot market were sufficient to undercut any manipulative practices. That is, the Commission would have to set terms on the outstanding number of shares, yearly trading volume, etc. related to a particular stock in order for it to qualify, on a continuing basis, as the underlying issue for a stock futures contract. The CFTC should consider the relevance of standards used by the SEC in evaluating stocks for options trading. Also, the Commission would need to be prepared -- with clear legal authority to do so -- to close out trading in a particular contract if an emerging corner or squeeze was detected. Also, a cash delivery mechanism for an

individual stock futures contract would not necessarily deter a corner or squeeze, or provide a solution to an emerging squeeze, since if the underlying issue were truly cornered it would be uncertain how a cash delivery price would be determined. These issues ought properly to be resolved prior to the approval of a contract based on an individual stock or narrow sectoral stock index.

In sum, although a stock index future could play a useful role in certain investment strategies, we are deeply concerned about the problems raised, particularly in the area of consumer protection and margin regulation. We think these problems must be resolved prior to your approval of trading in any stock future.

Sincerely,



Robert Carswell

Mr. John L. Manley
Director
Division of Trading and Markets
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Mr. JONES of Tennessee. The Chair will now recognize Mr. Hucky. Do you have any questions?

Mr. HUCKABY. No.

Mr. JONES of Tennessee. Mr. Glickman?

Mr. GLICKMAN. Thank you, Mr. Carswell. Your statement indicates a problem area that I have had over the past couple years, and that is not only the problem of massive amounts of capital being directed into the futures markets in financial futures, but also the economic effect on the aggregate economy.

The fact that the annual trading volume in Treasury bills futures contracts alone was about \$2 trillion in 1979 compared with nothing in 1975 concerns me. What is the aggregate effect of that in terms of the Nation's economy? Is money coming in here that would be going somewhere else? What is the effect on inflation? Do you have any comments?

Mr. CARSWELL. Clearly, money has to come from somewhere since the investments were made by people who had alternative investments to consider. For whatever reasons they decided to put them in the T-bill futures market, presumably because they thought they would make more money there.

The economic purpose that was served by that investment is hard for us to evaluate.

Mr. GLICKMAN. When you say "hard for us to evaluate" are you giving a qualitative opinion that you do not think there was any economic purpose?

Mr. CARSWELL. I did not say "any." Clearly, with \$2 trillion having moved in there in a period of less than 4 years, one would have to question whether or not some significant portion of it was

not speculation, the economic purposes of which are in my mind not necessarily constructive.

Mr. GLICKMAN. Do you know who is buying the contracts?

Mr. CARSWELL. We really do not. We have anecdotal evidence, but—the CFTC did a survey which to some extent identified who it is. It is spread all over the place from pool operations to individuals to firms that are actually in the Government securities business who are hedging their positions. Much of the trading even occurs abroad. We really have no way to be sure exactly where it is all coming from.

Mr. GLICKMAN. Do you believe one of the reasons people in great numbers are investing in these futures is because it provides an inflation hedge?

Mr. CARSWELL. I do not think so. My guess is that it is primarily a profit motive. I am not sure that the inflation hedge is really a—

Mr. GLICKMAN. Is the effect of this great investment inflationary in and of itself?

Mr. CARSWELL. That depends upon whether or not funds that would otherwise be used in more productive investments, and hence produce goods and services that are needed in the economy, are being diverted into T-bills. If there are, then I suppose it is inflationary to some extent.

Mr. GLICKMAN. Has anyone done the appropriate market studies or economic analyses to determine if in fact a diversion is occurring?

Mr. CARSWELL. We have one survey that the CFTC has done. As I say, this is a new development. No one really has responsibility for the kind of issue that you are raising.

We, obviously, are very much interested in it, as the ones that create the market, because it is after all a U.S. Government market. That is, the entire purpose of the market is to finance the national debt. It has no other purpose. We try to do our best to keep track of what is going on, but the statutory authority to run that kind of study is not present for us. It is in the CFTC and they only have a limited statutory authority to do it, so I think the answer is, We really do not know fully today what those futures markets are all about.

Mr. GLICKMAN. In your statement you indicated that deliveries reached roughly half of the available supply for December 1979's bill contract. What if that increased even more dramatically, where deliveries reached three-fourths of the available supply? What problems do you see developing in such an eventuality?

Mr. CARSWELL. It would be the Commission's problem. It would be equivalent to the kind of squeeze situation that it has faced in the commodities area, I suppose. It would have to decide then what to do about deliveries and suggest to the exchanges what they might do.

I assume that we would consult with them if we could.

Mr. GLICKMAN. You also talk about abnormal price relationships among the underlying cash markets bills. Could you be more specific?

Mr. CARSWELL. There are a whole range of Treasury securities outstanding, and they trade at various prices that you can see in

the newspapers. There is a curve that one can draw through those various prices, and there was an aberration in that curve in December. Actually it started a little earlier than December of last year. This particular maturity area was off the curve, between 5 and 10 basis points, which meant that there was investing going on for purposes other than mere yield. And that is the only conclusion one can come to.

Mr. GLICKMAN. Do you know what those purposes are?

Mr. CARSWELL. No. We can speculate about them, and there has been speculation, but I do not think anyone can really—

Mr. GLICKMAN. There is an implication in your statement that the CFTC—at least this is what I read and you may want to correct me—is either not capable or has not dealt with some of the underlying issues that you raise. Do you have any suggestions to this subcommittee as to what you would like to see done?

Mr. CARSWELL. I did not mean to be critical of the CFTC in the overall. I think what has happened here is the development of an entirely new set of markets and a Commission that is having to learn as it goes along. Because of the importance of this area, that is, of the Government securities markets, we are very anxious that that be handled in the most responsible possible way that it can be. I think the Commission is doing the best it can.

It does need, and I hope this subcommittee will see that it gets, whatever resources it needs to do this job. As it goes along we may have more specific suggestions. Again, our view has been that this ought to proceed in a very orderly and careful fashion and that we ought not take the risks in this area that could destabilize the market. After all, the single purpose of the market is to float our national debt at the best possible price for the American people.

Mr. GLICKMAN. Am I correct that you do not advocate right now the elimination of futures contracts in Government securities?

Mr. CARSWELL. No.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman. Mr. Madigan?

Mr. MADIGAN. Mr. Carswell, the people who are investing here, as opposed to putting the money in the savings and loan associations—because they are making more money—are also paying more taxes if they are making more money. Are they not?

Mr. CARSWELL. I wish I could answer that as a flat, yes; but we really do not know how the tax side of this trading is working out. There is some evidence, for instance, that what went on in December—the aberration I just talked about—represented market positions being taken for tax purposes. They might have been deferring taxes in the future or eliminating them by changing a category of tax payments from capital gains to ordinary income and so forth. That kind of thing is going on in the markets. Hence, I really cannot give you the answer you expect; namely, that if profits are being made, they are being taxed.

Mr. MADIGAN. If that kind of thing is going on, that could also be done by investing in a chicken ranch or cattle feedlot or any number of other types of investments that would be available to people with money to invest. Could it not?

Mr. CARSWELL. I would suggest that the convenience and anonymity of this kind of investment may make it more attractive for some.

Mr. MADIGAN. Can the tax be deferred forever?

Mr. CARSWELL. The Internal Revenue Service is obviously concerned about that possibility. That kind of issue has existed, of course, in other commodities markets. The taxation of commodities profits over the years has presented very difficult enforcement problems for the IRS. They are obviously doing the best they can with it, but it is an issue that is involved in these new markets, I am afraid.

Mr. MADIGAN. Are there some recommendations that you would have for us in terms of us looking into that further? Do you have some ideas about what we ought to look at and where we ought to look as a committee of Congress?

Mr. CARSWELL. I think my major recommendation today—and the only one really in my statement—is that you consider the resources and the overall statutory authority that the Commission has in the area—that is, the Commission and others. I think in the tax area the IRS is obviously, and has been for a good number of years, operating in the area, and there are right now a number of cases in litigation which may serve to answer some of the questions I imagine you would raise on the tax side once they have been decided.

Mr. MADIGAN. Thank you, Mr. Carswell.

Mr. JONES of Tennessee. Thank you, Mr. Madigan. Mr. Baldus?

Mr. BALDUS. I guess I will just say that it is refreshing to have someone come before the subcommittee and say that they do not know all these things. I do not know that it gives a great deal of comfort however.

To study some of these issues, on what scale of manpower and the like would you say it should be designed? I should preface that question by asking whether you think such a study would be most appropriately done by the CFTC?

Mr. CARSWELL. We, as you know, 2 years ago at the time of the 1978 act, suggested a somewhat different configuration for regulation of these markets than the Congress enacted. I have no real reason to change the position we took then.

On the other hand, I cannot say that this is working in a way that is unsatisfactory. I think I have expressed the two areas in which we have had concerns, namely, the area of too rapid proliferation of these contracts, which I think prohibits adequate study as you go along, and second, the area of customer and investor protection.

Mr. BALDUS. I do not recall what your position was then. Could you tell me what that was?

Mr. CARSWELL. Basically it involved, in effect, a veto for the Treasury Department on the authorization of new contracts and in some circumstances a suspension of existing contracts. It also involved a closer involvement with the Commission in some other areas.

Mr. BALDUS. Let us say, if the responsibility were lodged with the CFTC, what would your suggestion be as to scope of such a study?

Mr. CARSWELL. We have studies going now, sir. I do not mean to overstate the situation. We really are watching this very closely with the resources that we have in the Treasury Department. In fact we are starting a new study right now on the Government guaranteed end of this, namely, the Ginnie Mae part of the market, where there have been significant abuses in recent months and years.

Mr. BALDUS. Do you think you will be able to answer the question of who is investing and why?

Mr. CARSWELL. No, not all of that. That would take broader work than what we now have. It would also require reporting that the industry would probably not want to do, and so on.

Whenever one starts a new area, you can expect this kind of result if it is successful.

Mr. BALDUS. Nonetheless, I am a little concerned about all this much activity going on and the fact that we do not know why.

Mr. CARSWELL. That is why we suggested that one ought to move rather slowly, because this is what happens when you open up a new and attractive market, or potentially attractive market. That is exactly what did happen.

Mr. BALDUS. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Baldus.

Does any other member of the subcommittee have a question?

If not, Mr. Carswell, we do appreciate very much your being here and your very fine statement. As Mr. Baldus said, it is rather refreshing to have someone come before us that does not seem to have all the answers to our problems. We do appreciate your presence.

The subcommittee will stand in recess until 2 p.m. this afternoon, at which time the full committee will also be in session and we will be marking up the emergency credit bill as well.

[Whereupon, at 12:20 p.m., the subcommittee stood in recess to reconvene at 2 p.m. on the same day.]

AFTERNOON SESSION

Mr. GLICKMAN [acting chairman]. The subcommittee will resume its hearing on oversight into the operations of the Commodity Futures Trading Commission and the commodity futures markets.

This morning we heard from Chairman Stone and other personnel at the CFTC. We also heard from a representative of the Secretary of the Treasury's office, Deputy Secretary Robert Carswell.

This afternoon we will hear two witnesses, Ralph Ferrara, General Counsel of the Securities and Exchange Commission, and Mr. Peter Keir, an assistant at the Federal Reserve Board.

I might tell the witnesses that, first, unfortunately, when we have a hearing while the House is in session, we may be running back and forth to vote on the floor. You will have to excuse us for that. We also have a markup session in our other hearing room.

Ed Jones is the chairman of this subcommittee. He will not be here, at least for awhile, and has designated me to chair the hearing in his absence.

The second thing I will tell you is that your entire prepared statement will appear in the record, and you may feel free to

paraphrase, summarize or read them entirely, depending upon your desire.

The hearings this morning were very interesting. Particularly of interest was the testimony from the Deputy Secretary of the Treasury on the volume of futures in Treasury bill instruments. In light of that, we would be interested in your testimony.

Mr. Ferrara, it is a pleasure to welcome you here. As you know, I was formerly an attorney in the Division of Trading and Markets at the Commission. Why don't you begin.

It looks as though we have a vote, but we will wait 5 minutes.

STATEMENT OF RALPH C. FERRARA, GENERAL COUNSEL, SECURITIES AND EXCHANGE COMMISSION

Mr. FERRARA. Mr. Chairman and members of the subcommittee, in response to the request of Chairman Jones, I am pleased to appear before the subcommittee to discuss the working relationship between the Securities and Exchange Commission and the Commodity Futures Trading Commission. In my statement today I will review the areas in which the two agencies have cooperated. I will also bring to the subcommittee's attention certain areas of regulatory overlap which are of concern to the SEC and which may give rise to problems in the future.

As the subcommittee is aware, in the Futures Trading Act of 1978, Congress amended the Commodity Exchange Act to require the CFTC to consult with the SEC, as well as with the Department of the Treasury and the Board of Governors of the Federal Reserve System, on CFTC activities relating to the responsibilities of each respective agency. In accordance with the congressional directive, the CFTC and the SEC have maintained lines of communication between the members and staffs of the two agencies.

In 1978 the SEC, the CFTC, Treasury and the Board of Governors established a Policy Group on Financial Instrument Futures to which a policy-level representative was appointed by each participant. The Policy Group was organized to discuss broad policy aspects of mutual concern to its participants with a particular focus on contract market applications involving financial futures and stock index contracts.

In an effort to coordinate the regulatory process, the Policy Group has undertaken a study to compare the regulatory objectives and programs in the securities field, as administered by the SEC and the Board of Governors, with regulatory objectives and programs in the commodities field, as administered by the CFTC. As an initial step, the staffs of the SEC and the CFTC have each prepared for the Policy Group working papers explaining in some detail the respective regulatory requirements under the federal securities and commodities laws which seek to promote the protection of investors. In this connection, the staff of the Board of Governors has prepared a working paper on margin regulation and the staff of the SEC is currently drafting a working paper describing relevant aspects of its surveillance and enforcement system.

These initial working papers on investor protection, margin and market surveillance will form the basis for a second phase of the study in which a comparative analysis of the regulatory schemes of the SEC and the CFTC will be carried out. Through this approach,

we intend to identify material differences in these regulatory schemes and hope to reach some conclusions on whether regulatory disparities may have an adverse impact on the capital allocation decisions of market professionals and investors. If there is such an impact, we intend then to address whether regulatory disparities can be justified on public policy grounds and whether the regulatory schemes for securities and financial futures can be better rationalized to eliminate undesirable regulatory gaps or unnecessary duplication of effort.

To promote greater understanding of financial futures and securities markets, the Policy Group has thus far sponsored two seminars attended by senior officials and staff members of the respective agency participants. In December 1978, the Policy Group arranged a seminar on financial futures markets at which CFTC staff members and representatives of four financial institutions made presentations. Also in December, the director and staff members of the SEC's Special Study of the Options Markets explained to CFTC staff members some of the major findings and recommendations of the Special Study.

On a more informal basis, staff members of the SEC and the CFTC have consulted with each other on specific regulatory matters. As a result of interstaff consultation, the SEC and the CFTC have amended their respective net capital and minimum financial rules to provide a measure of uniformity for firms which are dually registered as securities broker-dealers and as futures commission merchants. Thus, the CFTC, in amending its minimum financial rules, has essentially adopted the SEC's approach for valuing securities positions. Similarly, the SEC has revised its net capital rule to conform to the CFTC's rules governing the valuation of futures positions. The financial reporting rules of the two agencies have also been harmonized in some respects. The CFTC has by rule permitted dually registered firms to file quarterly FOCUS filings made by those firms with the SEC. We, in turn, have permitted dual registrants to include in their quarterly FOCUS filings a Schedule of Segregation Requirements devised by the CFTC.

In the area of enforcement, staff members of the SEC's Division of Enforcement from time to time have brought to the attention of the CFTC's Division of Enforcement matters which may involve violations of the Commodity Exchange Act. Similarly, staff of the Commission's Office of Economic and Policy Research and staff of the CFTC's Division of Economics and Education have from time to time consulted with each other and exchanged memoranda on various issues of common interest.

In addition, the SEC and the CFTC have recently been asked to participate in an intergovernmental group to work with the Internal Revenue Service in regard to certain tax avoidance schemes involving futures or options. For example, silver straddles have been utilized primarily for tax avoidance purposes without any bona fide investment purpose. Similar problems could arise in the options markets.

Mr. GLICKMAN. Why don't you hold the rest of your statement until we get this vote taken care of. The subcommittee will recess until we finish the vote.

[Whereupon, at 2:25 p.m., the subcommittee stood in recess.]

Mr. GLICKMAN. The subcommittee will come to order.

I want to assure you that the demands of the schedules of the House and this subcommittee and our frequent absences in no way reflect what this subcommittee thinks about the importance of your testimony. It is one of the problems in this business. Why don't you continue.

Mr. FERRARA. Just prior to the recess, you will recall that I began by saying that the SEC was going to discuss two topics today: First, areas in which the CFTC and the SEC have engaged in cooperative efforts, principally focused on the Policy Group on Financial Instrument Futures and second, concerns of regulatory overlap which may give rise to problems between the two agencies. I would like to turn to the second topic now.

Of immediate concern to the SEC in this regard is the pending application of the Kansas City Board of Trade for designation as a futures contract market for a stock index. The SEC has submitted comments and has testified before the CFTC with respect to the KCBT's initial proposal to trade a contract based on the Dow Jones 30 industrial stock average. Later this month, the SEC intends to submit its comments on the revised contract submission of the KCBT to trade a contract based on the Value Line Stock Average. In our comments, we intend to discuss the functional similarities of index futures and stock options, to raise questions about regulatory disparities between financial futures and securities options and the implications for the Nation's capital formation process, and to appraise the CFTC of the lessons we have learned from our options study about the regulation of derivative securities.

Our reservations concerning the KCBT contract submission are heightened by the prospect that CFTC approval may pave the way for the index contracts on smaller groups of stocks and perhaps even to futures on single stocks. We understand that the Chicago Mercantile Exchange, for example, intends to apply to the CFTC for contract market designation of a number of stock index contracts based upon different industrial categories.

As the number and type of financial futures instruments expand, we are likely to witness a corresponding growth in the number of pools which are formed to channel investors' savings into these instruments. The creation of those financial futures pools gives rise, among other things, to questions concerning the applicability of the Investment Company Act to such pools and the applicability of the Investment Advisers Act to their advisers.

As the subcommittee may be aware, the staff of the SEC in a discretionary action recently took a no-action position on the applicability of the Investment Company and Advisers Acts to a pool whose holdings were limited to futures on securities which are exempt from the registration requirements of the Federal securities laws, namely, Treasury bills, notes and bonds, GNMA certificates and short term commercial paper. The SEC declined a request by the Investment Company Institute to reconsider the staff's position and the matter may ultimately be litigated. The staff in its no-action letter pointed out that the underlying securities, in view of their exempt status, were beyond the traditional regulatory concerns of the SEC. In contrast, approval by the CFTC of trading in futures on single equity securities or indexes comprised of such

securities would involve securities over which the SEC has been entrusted with broad regulatory authority.

Furthermore, the CFTC recently adopted rules governing, among other matters, disclosure requirements for commodity pool operators and commodity trading advisers. But the SEC had not been afforded a meaningful opportunity to comment on these proposals before they were adopted in January 1979. When the disclosure of the historical performance of trading advisers began appearing in commodity pool prospectuses filed under the Securities Act of 1933, the SEC's staff took serious exception to the adequacy and accuracy of the CFTC mandated disclosures. Our staff informed the CFTC of the nature and extent of our problems with their disclosure requirement. To the best of our knowledge, the CFTC staff has now tentatively agreed to revise their requirements and to give this agency the opportunity to comment on their revised proposals.

We will, of course, endeavor to resolve these concerns through communications with the CFTC. Thus, we have been submitting comments to the CFTC on proposals for stock index futures, and we allowed the CFTC to make a submission to the SEC before deciding to issue the above mentioned no-action letter under the Investment Company Act and the Investment Advisers Act. However, if our comments are not taken into account and our regulatory concerns are not resolved, it may be necessary for Congress to reconsider the allocation of jurisdiction with respect to financial futures, especially futures on equity securities and stock indexes, and to bring the regulatory scheme for such futures in line with the current framework for securities options.

I thank you again for the opportunity to address the subcommittee and I shall be happy to respond to any questions.

I think overall, Mr. Chairman, the record demonstrates, particularly in the course of the last 2 years, a close cooperation between the two Commissions in trying to work out some very tough, very knotty regulatory problems. We have, I think, enjoyed a considerable degree of success, given the positions we both began from. That is not to say that there are no difficult issues left to resolve.

Mr. GLICKMAN. Thank you.

As you know, when we authorized the agency in 1978, I am not sure you were involved in the process, the previous General Counsel, Harvey Pitt, and the chairman and I were involved in a conversation on many occasions about how we should limit statutorily the role of the CFTC to approving a future on a limited number of securities. If I may paraphrase what you say, you have no problem with the communication roles that you have shared with the CFTC on these matters to date. Is that correct?

Mr. FERRARA. Let me put it another way. I think that the consultative role that Congress envisioned in the 1978 reauthorization act is working just as Congress intended, but that does not mean that merely a consultative role given to the SEC serves as an adequate vehicle to address all of the SEC's problems. Had the Congress chosen another vehicle for resolving those concerns back in 1978, we might have been able to resolve even more problems.

Mr. GLICKMAN. For example, you indicate that the CFTC's rules governing commodity pool operators and commodity trading advisers were enacted before you had been given the opportunity to

comment on them. Does that imply that they did not give you a chance to do so? It is on top of page 6 of your statement.

Mr. FERRARA. My recollection of those rules—I would like to characterize it as a breach in the relationship, because my recollection is that the CFTC may have adopted the rules without giving notice and comment generally. I am not suggesting that they were required to do otherwise. It is the kind of proposal that I would hope would normally have been subject to the consultative process. I would like to regard it as a break in the relationship rather than identify it as an example of why the relationship is not quite what it should be.

Mr. GLICKMAN. I cannot envision that they could issue rules redefining commodity pool operators without adequate notice in the Federal Register unless there was some emergency.

Mr. FERRARA. My recollection is that they may have been faulty on that. I can check into it and advise you and supplement the record.

Mr. GLICKMAN. I would only be interested if there was somehow a failure to consult or a failure to notify. You might want to check on that.

I would like to ask you again about futures on indexes or securities. The SEC has not taken any position in opposition from the statutory point of view to the futures that have been filed by the Kansas City Board of Trade, the Standard and Poor's Index. Were you talking about a broad range of securities? Or have you taken a position?

Mr. FERRARA. I think we have raised, in the course of comments to the CFTC, very definite concerns about the KCBT's proposal. We have indicated to the Commission that we believe the proposal as originally defined, that is, a futures contract which contemplated delivery of a security, was itself a security in addition to being a future. That, of course, raised questions about the applicability of section 2(a)(1) of the Commodity Exchange Act, the exclusivity of their jurisdiction and the applicability of the reserve clause in section 2(a)(1) relating to nothing in the act impeding the ability of the SEC to perform its functions.

We did not raise at that time, but I suspect would raise if asked, that the change in the proposal which now contemplates cash delivery does not necessarily relieve the SEC's concerns. Although the SEC has not actually made a decision on the matter yet, the staff might advise the SEC that the KCBT index settled by cash instead of delivery of the security, would involve an investment contract under the Federal securities laws, and that, in turn, would raise questions regarding the exclusive jurisdiction provision of the Commodity Exchange Act and the SEC's concerns.

We have raised that issue with the CFTC in the past. The labeling of the futures instrument, the derivative security, also as a security for purposes of the Federal securities laws has, as you know, other consequences for those who trade in them. For example, I believe that if the instrument is appropriately characterized as a security under the Exchange Act, the Board of Governors of the Federal Reserve System may apply margin requirements.

If pools were organized to invest primarily in those derivative instruments—futures that are also securities—questions would be

raised under the Investment Company Act of 1940. That is, entities that primarily engage in the investment of those securities could be investment companies and subject to registration, or those who advise such pools could be investment advisers under the Investment Advisers Act. Again, in both instances, a question is raised as to the exclusivity matter.

We have raised these issues and will continue to raise them with the CFTC.

Mr. GLICKMAN. Can you work them out? Congress, when we passed the law, while there was some problem with making the language as specific as you might have liked or even I might have liked, had the intention that some of the niceties of the law should not get in the way of providing an appropriate conciliatory, statutory framework. I gather that no action has been taken on any of these indexes to date.

Mr. FERRARA. That is correct.

Mr. GLICKMAN. Part of that may have been because of your action in the matter.

Mr. FERRARA. But the cutting edge of your question, that is, whether or not there is likely to be a renewed or a new confrontation between the SEC and CFTC on the so-called jurisdictional ground is raised by this KCBT proposal. So far, I think that press accounts about the SEC and the CFTC being at loggerheads over jurisdictional or turf questions has been largely overstated, but there is certainly a grain of truth to it, and this is one issue in which we will both have to work very hard to try to resolve what could clearly end up being serious jurisdictional differences. And, in working very hard, the SEC and the CFTC are going to address, Mr. Chairman, several differing considerations, that is, promoting investor protection which is really the objective of both agencies, promoting capital formation, and the development of risk hedging or risk transfer mechanisms that Congress intended to be developed in 1974 when it adopted the Commodity Futures Trading Commission Act. It is not an easy process.

Mr. GLICKMAN. We only have about 5 minutes to continue. Have you done any internal economic studies on the capital formation issues raised by great increases in volume of financial futures?

Mr. FERRARA. We have tried to look at that question in the past. I can tell you that it is not easy to try to determine whether or not financial futures divert or contribute to the capital formation process. We have looked at it in the abstract, but, of course, we have never had to confront the situation of a proposal to designate a contract market to trade futures on securities, that is, traditional equity securities. That is where, I suppose, you could most closely examine whether there are going to be diversions—

Mr. GLICKMAN. But you have not come out with a study on that economic issue, have you?

Mr. FERRARA. We have not.

Mr. GLICKMAN. This morning, the Treasury Department testified that in 1979 trading in futures on Treasury bills in the aggregate amounted to \$2 trillion worth of trading. Two trillion dollars! That is compared to 1975 when it was zero. I asked them, What does this mean?, and their response was, We are really not sure.

Mr. FERRARA. I am not sure that anyone can answer right now the question of whether that amounts to a diversion in normal channels in which capital flows or if, to some extent, because of the risk transfer character of futures, it might to some degree enhance the flow. But, you are right on target with what the question is, I think.

Mr. GLICKMAN. All right. You indicate that you have worked out problems dealing with broker-dealer cross compliance with the CFTC. Is that a fair statement?

Mr. FERRARA. That is where we have had the greatest success in working out areas of mutual concern.

Mr. GLICKMAN. I see. My final question is, Would it be a fair statement to say that you would view a future on a single stock to be well within your jurisdiction as roughly equivalent to an option?

Mr. FERRARA. That would certainly be the view that we would take, and I will tell you that that is the area of absolutely greatest concern to the SEC.

In response to your other question, I hope I did not indicate that there is any question about our ability to work out financial responsibility requirements with the CFTC relating to futures commission merchants and broker-dealers in securities, or that all problems have been worked out. We have had some modest degree of success, basically in the net capital and reporting areas, but a lot remains to be done in terms of other financial responsibility rules, selling practices, trading practices, and so on.

Mr. GLICKMAN. Mr. POZEN.

Mr. POZEN. May I also add that we have now proposals for options on indexes, including one for the option on the shares of a mutual fund that invests in the Standard and Poor's 500, so although an option on an individual security would be most comparable to the futures on an individual security, as we have developments in the options field, I think we are going to see a broader range of comparability.

Mr. GLICKMAN. Has anyone done any economic analyses as to the economic differences between an option on an index and a future on an index?

Mr. POZEN. I think there have been economic analyses done. I think that basically they share some very important similarities in that they are derivatively priced and can be used as hedging devices. There are some technical differences and some different risk and return relationships along the curves, but in general terms they are pretty much the same. You can find differences because of timing. And you can find differences because a futures contract is basically a bilateral contract, so at the end of the futures period, if you have not closed out your contract, you can wind up with an exposure of the whole contract. While in the options area, the maximum exposure you can get is from the premium, because if you do not do anything, all you can lose is your premium.

Mr. FERRARA. What greatly concerns me, Mr. Chairman, is that if this subcommittee asks the SEC, and the CFTC, and the Fed and the Treasury to produce for you a battery of economists liberally larded with some economists from the private sector, and you ask them that question, they would probably be able to detail for you a laundry list of economic differences and perhaps even support that

with some reference to an empirical data base that they either have or could develop. But the reality of it to me—I am not an economist—is that basically both are risk transfer mechanisms and those who sell them to the public are basically going to be regarding them as virtually identical risk transfer mechanisms. However, in one case, the risk transfer mechanism is going to be subject to SEC oversight and is going to be engrafted with perhaps more regulatory and investor-oriented protections than the other. In that situation, what we are afraid is likely to happen is that the business is going to flow to the lowest level of regulatory restriction. Whatever the economic differences are, the reality, I am afraid, will be lost upon the investor who walks into the office of the FCM or the broker-dealer and says, I want to transfer some risk on my portfolio. That is the real problem to me.

Mr. GLICKMAN. We will have to break now. We appreciate your testimony. One thing I would be interested in as time goes on—and I told your chairman this too—is to continue to keep the committee informed as to regulatory matters that concern you, because this committee does retain exclusive jurisdiction over these matters and we would like to know if there are areas where you think there may need to be some statutory changes at the appropriate time.

We will recess until the vote and we will come back for you, Mr. Keir.

[Whereupon, at 3:18 p.m., the subcommittee stood in recess.]
Mr. GLICKMAN. The subcommittee will resume.

Mr. Keir, it is a pleasure to have you here. As I told the other witnesses before, it is satisfactory to us if you wish to summarize your views. They will appear in their entirety in the record in any case. You may read them if that is your desire.

Please proceed.

STATEMENT OF PETER M. KEIR, ASSISTANT TO THE BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. KEIR. Mr. Chairman, my name is Peter Keir. I am an assistant to the Board of Governors of the Federal Reserve System. I am pleased to respond to your request for an assessment of how well coordination between the Commodity Futures Trading Commission and the Federal Reserve has worked in the areas of our mutual interest. One of my functions at the Board has been to serve as the Board's liaison officer to the CFTC on questions involving markets for Treasury futures.

I am accompanied by Donald Kohn, who is chief of the Board's Capital Markets Section. He has participated in much of the research we have been doing on financial futures.

As you know, the 1978 legislation that renewed the authority of the CFTC to regulate futures markets also directed the Commission to elicit the advice of the Treasury and the Federal Reserve before authorizing any additional futures contracts calling for delivery of Treasury securities. When reviewing this advice, the Commission is expected to assess the likely effects of such contracts on the debt management responsibilities of the Treasury and on the general efficiency and integrity of cash markets for U.S. Government securities.

In the period since passage of the 1978 act, the CFTC has taken the lead in assuring needed coordination with the Treasury, the SEC, and the Federal Reserve. Shortly after the 1978 legislation was signed, the Commission invited representatives from these agencies to participate with it on an informal coordinating committee. The group has served since then as a useful forum for face-to-face discussion of common problems.

At the time the authority of the CFTC was renewed a sizable number of requests had accumulated for additional new contracts in Treasury futures. These requests sought to extend trading to additional commodity exchanges and to types of contracts not previously traded—involving the delivery of intermediate term Treasury securities as well as long term bonds and bills. Since the bill and bond contracts already trading were then showing rapid growth, the 1978 requests for additional new contracts raised important questions regarding the possible impact of such contracts on the basic cash market for Treasury securities. The answers to these questions were important to the Treasury and to the Federal Reserve, because an effectively functioning cash market in Government securities is critical both to the successful execution of Federal debt management and to the effective implementation of Federal Reserve open market operations.

To assure a considered assessment of such questions, the Treasury and the Federal Reserve urged the CFTC to defer approval of the large backlog of pending requests for new Treasury futures contracts until their economic implications could be more carefully evaluated. The two agencies volunteered to undertake and complete such a study by the spring of 1979. The CFTC acknowledged that a study of this type would be beneficial if it could be completed expeditiously.

We did manage to get it done expeditiously, and in retrospect we believe this pause for a more considered evaluation of the proposed expansion in Treasury futures contracts was very useful. We believe it helped both us and the CFTC to gain a better understanding of the developing interaction between the cash and futures markets in Treasury securities. In addition, the study provided a full interchange of ideas on what appeared to be deficiencies in the specification of deliverable supplies for some of the proposed—as well as some existing—Treasury futures contracts.

During the course of our study we had several extended discussions with members and staff of the CFTC. Once our report and recommendations were completed, the CFTC reviewed them thoroughly and responded with a detailed set of counterproposals. They accepted some of our suggestions, adapted others in alternative ways that seemed reasonable and explained their reasoning regarding points on which they disagreed. In the roughly 9 months that have elapsed since our study was completed, discussions with the CFTC on additional new contract proposals have continued in the same cooperative vein. In short, the record of interagency coordination on Treasury futures contracts has been good.

This does not mean however that all of the Federal Reserve's questions and concerns about markets for Treasury futures have been resolved. For example, we would have preferred that the CFTC adopt a more gradual timetable than it did in the extension

of new contracts to additional maturity areas and to competing exchanges—even though we acknowledge that the drive for competitive equity among exchanges would have made the implementation of such a gradual timetable difficult.

The liberal approach actually followed by the CFTC in authorizing a broader range of contracts on additional exchanges does not appear thus far to have added seriously to pressures on deliverable supplies at least partly because the recently authorized contracts have not attracted much of a following. Instead, most of the continued expansion of trading in Treasury futures has occurred in the limited number of older contracts that have developed a high degree of liquidity.

This pattern of growth is about what had been predicted by old hands on the commodity exchanges, who had urged the CFTC to authorize new contracts freely and then to allow market competition to determine which contracts survived. However, it still remains to be seen whether pressures on deliverable supplies from new contracts will intensify once the better capitalized New York Futures Exchange enters the competition and the Comex gains more experience with its still relatively new contracts.

Among the older high-volume contracts, performance has generally been satisfactory. However, the fact that deliveries on the CME's active 3-month Treasury bill contract are limited to a single maturity has on occasion exerted pressure on the deliverable supply and created some distortion of yield relationships in the cash market. One such situation developed last spring when demands for delivery on the June contract threatened to run very high. At that time, speculators were widely expected to seek delivery on a significant part of their heavy long positions in order to profit from a cyclical downturn that appeared to be developing in interest rates. If interest rate expectations has not been abruptly reversed by the publication of unexpectedly strong economic statistics around mid-June, deliveries on the June contract could have run much higher and might then have produced larger distortions in the cash market than actually developed.

Again in December of last year, deliveries on the 3-month bill contract expanded sharply, reaching a record \$1 billion, or nearly 50 percent of the estimated supply available for delivery in the cash market. The strong interest in taking delivery of bills at year's end appear to have been traceable in part to efforts of some participants to reduce their tax liabilities. Current IRS rules require that losses incurred on futures contracts closed out by offsetting trades be treated as capital losses. However, if delivery is taken on a bill futures contract and the bill is then sold in the cash market, any loss incurred can be charged against current income.

These percent episodes of pressure on the cash market supply of bills deliverable against regular 3-month bill futures contracts have admittedly created fairly minor and short-lived market distortions. They do raise enough questions, however, to warrant further efforts by the CFTC to redefine the terms of bill contracts so they will be less vulnerable to a squeeze. While the CME argues that its emergency rules are perfectly adequate to cope with the limited number of situations in which a squeeze might develop, the record suggests that commodity exchanges typically have a strong incen-

tive to defer emergency action until the last minute. Given this propensity to temporize, it would seem desirable to avoid such potential problems by respecifying the existing contracts to encompass a broader deliverable supply, so long as this can be accomplished without appreciably reducing the contracts' financial appeal. I understand that the CFTC and the exchanges have been exploring possible ways to achieve this objective and I hope their efforts are successful.

Looking more broadly at the economic functions being served by markets for Treasury futures, it is clear that the Treasury—as the producer of debt deliverable in these markets—does not have the need to hedge against price changes that farmers do in agricultural commodity futures, or that mortgage bankers do in markets for GNMA securities. In these other markets the production process itself creates the need to hedge. Hedgers using Treasury futures, on the other hand, are simply buying an available service that happens to dovetail with their particular financial strategies.

Unfortunately, as Mr. Carswell suggested this morning, no reliable statistical measures are available that identify the particular financial objectives being sought by market participants using Treasury futures. Moreover, where hedging does occur, it seldom assumes the classic textbook form of complete risk avoidance. For example, Government securities dealers, who typically earn a large share of their income by taking positions in anticipation of interest rate changes, still frequently find it useful to establish short positions in bond futures as a means of hedging interest rate risks when underwriting Treasury offerings of new long term debt. In fact, if dealers had not access to such hedging possibilities over the past year, the general efficiency of financial markets might well have suffered substantially more than it has, in view of the greatly increased interest rate volatility that has developed in this period.

Rough judgments expressed by market participants do nevertheless suggest that the share of transactions undertaken in Treasury futures for essentially hedging purposes is not particularly large. The bulk of transactions appear to be designed to facilitate interest rate speculation, and a growing share of activity apparently reflects efforts to avoid taxes. Of course, some speculators seek to limit their risks by confining their operations essentially to arbitrage transactions—i.e., they take positions in anticipation of changes in interest rate levels. But their purpose in these operations is still essentially speculative.

In conclusion, it seems clear from the record to date that neither the extreme enthusiasm nor the grave concerns that have sometimes been expressed about Treasury futures markets have been justified. Most of the time these markets have operated fairly smoothly, and the few signs of problems that have emerged have been fairly well contained. Nevertheless in markets that have been evolving so rapidly it is difficult to keep in touch with all of the ramifications and implications of what is happening. Under such conditions, all of the Government agencies involved—as well as the market participants themselves—would seem well advised to maintain a close surveillance of future developments to make sure that no significant problems are emerging.

This completes my prepared testimony. You will note that I have not addressed the subject of stock market futures, about which you raised some earlier questions. Chairman Stone referred to such contracts as one of the more exotic approaches being considered. The Federal Reserve, as the regulator of margin requirements in the stock market, does obviously have a special interest in this area. If stock market futures were authorized, market participants could use them as a way to get around margin requirements, in the options market in particular but also in the cash market for stocks.

We do have an interest in this question and have had some interchange with the CFTC on it.

Any other questions you may have I will be glad to answer.

Mr. GLICKMAN. Thank you very much, Mr. Keir. You raise an interesting point on page 8 of your statement. It conforms to what Mr. Carswell said, that is, the transactions in Treasury futures seems essentially designed for purposes other than hedging.

Mr. KEIR. I did not mean to imply that there is not a sizable volume of hedging activity going on. I was simply talking about the relative importance of speculation versus hedging. Hedging operations appear to represent well under half of total activity.

Mr. GLICKMAN. Would you say the proportion of hedging in the Treasury futures is significantly less than hedging in commodity futures?

Mr. KEIR. I would think that would probably be so. Farmers and mortgage bankers have an inherent need to hedge in markets for agricultural commodities and GNMA securities as a part of the production process, whereas the U.S. Treasury, which creates the debt delivered against Treasury futures contracts, does not.

Mr. GLICKMAN. The interesting point this raises is the economic justification for approving futures contracts. Although I have not looked at the 1974 statute, but the statute relates to some of the classic rationales for hedging in the first place. I am not saying that we should not allow them. I do not see any reason not to allow them, but I am saying that there may be a need to expand some of the statutory definitions, because perhaps some of these futures are going beyond the range of what was anticipated by Congress when we enacted the 1974 act.

Mr. KEIR. I think one of the problems is that it is very hard to identify what the purpose of somebody operating in the Treasury futures market is. It is clear that some transactions are designed at least partly for hedging, but much of the activity is essentially speculative. You have to look at the whole balance sheet of the particular firm involved to figure out what its financial objectives really are. It is partly this type of problem—namely, of trying to identify who is really hedging—that complicates this market, although it should, of course, be recognized that a sizable volume of speculative activity is needed to make hedging possible.

Mr. GLICKMAN. You also indicate on page 7 of your testimony, "For example, Government securities dealers, who typically earn a large share of their income by taking positions in anticipation of interest rate changes * * *". I want to ask you what the effect of what Mr. Carswell testified was \$2 trillion worth of Treasury futures trading would have on interest rates in general and yields on

the Treasury bills themselves. Do you have any feeling about any correlations there?

Mr. KEIR. A number of studies have been made trying to sort out what these relationships are. Many studies have concluded that trader access to futures markets helps to dampen price and yield fluctuations in the cash market. As I noted earlier, the fact that dealers have recently been able to take offsetting positions in financial futures has probably operated to dampen price and yield movements in cash markets relative to what would have developed had there been no futures market.

Mr. GLICKMAN. Let me ask you one other question. I asked Mr. Carswell what the source of all this money is that is flowing into Treasury futures. He really did not know. Do you have any idea about that?

The second question is related to something else he said. He mentioned the anonymity of trading in Treasury futures. Are there disclosure requirements in Government securities that you would not have to disclose if you traded in futures on those Government securities? For example, if foreigners owned futures, would they have to file under the disclosure requirements or would they not?

Mr. KEIR. I would have to check the disclosure question out with our international people to see whether futures positions are an item that must be reported to the Treasury on the standard balance-of-payments reports.

Mr. GLICKMAN. You see, that may be a significant issue, to see whether people are either intentionally or in good faith not complying or disclosing interests in futures in the same way that they would have to disclose interests in underlying securities.

Mr. KEIR. As I indicated earlier dealers in Government securities are one of the groups that participates actively in Treasury futures. By engaging in arbitrage transactions between the futures and cash markets, they help to keep prices in the two markets closely aligned. As a part of our regular Government security dealer reporting program, we are about to begin collecting data on dealer positions and transactions in futures. Once such data become available, we will know much more about the interaction between Treasury cash and futures markets than we have in the past.

Mr. GLICKMAN. Will you share that information with the CFTC?

Mr. KEIR. We will share the aggregate numbers. Where positions of individual firms are involved, we must be careful to maintain our commitments on confidentiality. The CFTC has helped to keep us informed on what has been happening in Treasury futures markets where we have not had dealer position data in the past.

Mr. GLICKMAN. Returning to the first question, besides Government securities dealers, do you have any idea what types of people have so dramatically entered the trading in Treasury futures?

Mr. KEIR. The surveys the CFTC has made identify the types of institutions and classes individuals that are involved in these markets. It is partly from such data that we have gained the impression that financial institutions—such as commercial banks, which as you know operate under certain regulatory constraints regarding the extent to which they can participate in financial futures, and some other types of financial institutions—have not yet used these markets as actively as one might have expected. I think

growth of their interest in financial futures is partly a learning process, which may well develop as time passes.

We have talked to officers of a number of types of financial institutions and have found a growing interest on their part. Thus far, however, it is typically market professionals and individuals, like those involved in the stock market, that show the greatest interest in financial futures.

Mr. GLICKMAN. I have two final questions. You mention on pages 5 and 6 about these 3-month bill futures. You talk about the fact that there have been fairly minor and short-lived market distortions, and you talk about the problem of the squeeze. You indicate that so far this has not been a problem. Can you foresee a situation developing in which we could have a serious problem?

Mr. KEIR. I think that some people would say that what has happened already has to some extent been a problem, because there have been opportunities for financial institutions to obtain special profits by taking advantage of a scarcity of supply in the cash bill deliverable against a maturing bill futures contract. The leeway for squeezing a special advantage out of such a situation should not be exaggerated, but it should be recognized that the possibility of a squeeze is there. For example, the episode last June could have been a bigger problem had the market not turned around before the delivery date on June futures.

In our Treasury-Federal Reserve study we suggested that there are ways to avoid the risk of a squeeze on deliverable supply, simply by expanding the number of outstanding bills that are eligible for delivery. In this way investors wanting to take delivery can be readily accommodated.

Mr. GLICKMAN. And the final question is: "Do you have any recommendations for us on any statutory changes in the CFTC's authority that we might want to consider?"

Mr. KEIR. No, I do not think so at this time. But some suggestions may develop later out of the discussion of stock futures when that question is taken up by the CFTC.

Mr. GLICKMAN. You feel that your communications with the CFTC have been pretty much as Congress intended when we passed the amendments—

Mr. KEIR. Very much so. The CFTC has gone out of its way to be helpful.

Mr. GLICKMAN. We thank you for testifying. Unfortunately, you are stuck with only me today.

These hearings have been informative. I have finally found a group of people who have great interest in seeing the national debt continue at great levels, and that, of course, is people in this business. [Laughter.]

I wonder if Chairman Stone is still in the room? Or is there anyone here from the CFTC?

Commissioner Dunn, Dr. Culver, and Mr. Tendick, will you come up for a minute please? I would like to ask you a couple of final questions, if you do not mind.

Dr. Culver gave me some data that, I believe, I requested. One is the percent change in average month-end open interest on all the different commodities. Two of the pages relate to that. Then there is the status of futures trading for fiscal year 1979, and those are

two pages that list all the contracts that have been submitted to you.

Mr. DUNN. Is that sufficient to answer your question?

Mr. GLICKMAN. I think so, and if it is not, we will ask for more.

Commissioner Dunn, it is good that you are here. As you have heard the testimony, are there any additional comments that you might have to make to the subcommittee that might be particularly relevant in this first set of hearings?

Mr. DUNN. Did you mean particularly with regard to the testimony given by witnesses from the other three organizations?

Mr. GLICKMAN. Yes, but you may include anything independent that you might want to say.

Mr. DUNN. I do think that there are a few points on which some clarification on our part might be useful to the subcommittee. You, yourself, have made repeated reference to the \$2 trillion figure that Mr. Carswell mentioned in his statement this morning. People from time to time do use the total value of commodities that are traded, and I think that it is unfortunate that those figures are bandied about, because the significance of them is not at all in line with that enormous figure.

Commodities do not change hands in anything like that magnitude. I think a much more meaningful figure is the amount of money which does actually change hands, and this is essentially the fees that are paid out by buyers or sellers to the brokers, the brokers to the clearinghouses, and so forth. That figure—I do not have it in my mind right now—is nominal by comparison to the trillions that were mentioned.

Mr. GLICKMAN. It was a significant increase.

Mr. DUNN. Oh, yes. There is no question that the total volume of transactions in the financial instruments is large. It is certainly large, but it is less than 10 percent of the total number of contracts which are traded in all commodities on all futures. During this fiscal year it was 6 point something percent. I am sure that currently the rate is not more than 10 percent.

Both Mr. Carswell and Mr. Keir stated that it appears that most of the transactions are for the purpose of speculation and the purpose of hedging. I am sure that the word most is accurate, but as Mr. Keir said in his final comment, it is difficult to know precisely what these organizations are doing by just looking at their positions in the futures market. This is especially true in looking at financial organizations like banks which have so many different types of assets and liabilities.

He is correct that it is quite difficult to show that a position in the futures markets is a precise hedge against any one individual liability or asset. The primary reason is because of the different time components of the various assets and liabilities which banks have. They have a wide range of times attached to them, and it may be almost unique that the futures market position has precisely the same timeframe as the asset or the liability which the futures transaction is intended to hedge.

I would comment further that in the early days of the financial instruments I also wondered just exactly what was being done and what these transactions actually were. I am sure that in the early days, many of the financial organizations went into them on simple

arbitrage types of transaction, but what has impressed me is that the greater the experience of these firms in the market, the more their activities and transactions get to look classical.

Mr. GLICKMAN. I did not understand you just then.

Mr. DUNN. They get to look like a classical hedging transaction. In other words, they get to look like a short position to hedge an inventory on a particular transaction.

The people in the financial community are still getting familiar with futures and getting to learn how to use futures.

Mr. GLICKMAN. It is obvious that we are in an extraordinarily fertile period in dealing with concepts that were unknown 10 years ago. I think your comments are very good on that point.

If I may, I would like to ask you an unrelated question. This is something that does not relate to the financial futures issue. It relates back to the grain embargo issue. Has there been any litigation filed against the Commission on that issue either on the merits of the issue or on collateral things, for example, disclosure of minutes at hearings and that kind of thing.

Mr. DUNN. Let me check with my colleagues.

Mr. GLICKMAN. I just want to know the status.

Mr. TENDICK. As far as I know there have been no suits filed. We do have a freedom of information request which we anticipate will be filed. They have asked for the minutes of the closed meeting in which the Commission took the action on the Sunday to close the markets. There have not been any papers filed at this point.

Mr. GLICKMAN. Then there is not current litigation but there may be some.

Mr. TENDICK. That is right.

There is one other thing, Mr. Chairman. I would like to ask if we might supplement the record with the commodity trading advisers' commodity pool regs which we published in the Federal Register in response to Mr. Ferrara's earlier comments. They were published.

Mr. GLICKMAN. Were they published in accordance with the administrative Procedure Act? All right, if that is your desire. Without objection, the regulations will be included in the record of today's hearing.

[The excerpts from the Federal Register, Tuesday, February 15, 1977, pp. 9266—9276 and pp. 9278—9284 are held in the subcommittee file.]

Mr. DUNN. Mr. Chairman, I would like to make just one further comment, if I may. With regard to the previous statement, as has been mentioned, I was the one who was asked to serve for the CFTC on the interagency group. I appreciate the comments that were made by the others on the cooperation. We have tried to cooperate as intended by the Congress, not only to carry out the congressional intention but also to learn as much as we could from the other agencies about these new instruments, because this concept of futures on financial instruments is new. We are still in a learning process. We very much appreciate the cooperative attitude of the other three organizations in helping us to understand the problem.

Mr. GLICKMAN. It does appear that you have been sharing information and that was the main intent of Congress when we added that amendment in 1978. Obviously, nobody has anything to gain

by unnecessary jurisdictional fights. At the same time, all the agencies are trying to enforce the law as they determine Congress intended it, but I am glad to see that the interagency groups and the communication has been healthy and that there has been tangible proof of that through some of the things that we have heard about today.

I think that these have been productive hearings. I might tell you that the committee may have at least a day of public hearings at some point in the future. I am sure that members of the appropriate exchanges and boards of trade, as well as any other interested people, will be free to give their thoughts on what they have heard today as well as any constructive criticisms or changes either in CFTC rules or activities, or perhaps something in statute might be appropriate.

If there is no other testimony, the hearing stands adjourned. We thank the Commission for its cooperation and extraordinarily fine testimony.

Mr. DUNN. Thank you, Mr. Chairman. We very much appreciate the interest and consideration shown by you and this committee.

[Whereupon, at 4:05 p.m., the subcommittee was adjourned.]

CFTC REGULATORY AUTHORITY REVIEW

WEDNESDAY, MAY 21, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSERVATION AND CREDIT
OF THE COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 1301, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Huckaby, Glickman, Hance, Richmond, Baldus, English, Daschle, Madigan, Coleman, and Hopkins.

Also present: Representatives de la Garza, Rose, Fithian, and Wampler.

Staff present: Fowler C. West, staff director; Robert M. Bor, chief counsel; John E. Hogan, counsel; Robert T. Lowerre and J. Robert Franks, associate counsels; Glenda Temple, clerk; Kathleen Garvin, Robert Cashdollar, James Johnson, Wayne Fletcher, Rita DiSimone, Peggy Pecore, and Bernard Brenner.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will come to order.

As we begin this morning, it is possible that some members of the subcommittee may have some opening statements to make themselves. I have one to make which I will give first, and then at the same time lay down the ground rules for the hearing today.

I want to welcome each of you to these hearings. The subcommittee, on February 12, 1980, began a series of oversight hearings on futures market regulations. Unfortunately, the assurances we got just a little over 3 months ago seemed to have been tossed out the window very quickly, so we are beginning over again with the same agencies which assured us everything was being completely and competently managed.

Specifically, the subcommittee this week will explore the question of whether or not the CFTC has sufficient authority to adequately regulate commodity futures trading. One bill to grant CFTC standby authority to set margin requirements has already been introduced by Representative Glickman who is a member of this subcommittee.

The hearings should focus as well on other regulatory matters, including speculative position limits, the adequacy of self-regulation by the exchanges, possible conflicts of interest within the industry and, finally, CFTC's responsibility to prevent market emergency situations.

As case studies, the subcommittee will look at the March 1979 wheat contract problem and the more recent silver situation. The subcommittee investigated the March wheat problem and has the benefit of Dr. Heifner's excellent report on it, which I intend to make a part of this hearing record.

The March wheat incident convinced me of the uselessness of injecting a lot of congressional hearings into a market situation prior to letting the dust settle. But the silver situation deserves close congressional oversight. I intend to provide that oversight and to seek the best available counsel on remedial action.

Weeks ago, Mr. Madigan and I instructed our staff to start preparation for this review. Our intention is that these hearings will be thorough, will be issue oriented, and will result in reasoned action. I have been here too long to believe in quick-fix solutions to very complicated problems.

No doubt, the members of this subcommittee have a better understanding of the basics of the futures market than any other on the Hill.

No doubt, as well, that we individually are sometimes frustrated by the complexities of futures markets. However, we are not cowed by that complexity. We are permitted and committed to providing this Nation with the most reliable and most sensitive and the best regulated markets in the world.

If our markets do not truly perform as mechanisms for hedging, for risk transfer and for price discovery, they have no reason for being. It is incumbent on the industry witnesses at this hearing to demonstrate that the markets meet this test and it is incumbent on the Government regulators to demonstrate that they are competent to carry that mandate as well.

It is a tough test and I, for one, am rapidly losing patience with both industry and its regulators, and I am recognized as a very patient man.

For your information, I announced late yesterday that Nelson Bunker Hunt and Herbert Hunt, originally scheduled to testify tomorrow, will appear on Thursday, May 29. Personal business matters prohibited their appearance tomorrow. Additionally, witnesses originally scheduled for Friday, May 23, have been asked to reschedule for May 22 or May 29.

I regret any inconvenience caused to any witness. I asked them to contact the subcommittee staff about arrangements.

Finally, for today's hearings I have instituted rather stringent guidelines so as to be fair to all witnesses and subcommittee members. I ask your full cooperation since we have a long witness list and a lot of ground to cover.

First, we will hear the statements of each Government witness—the CFTC, the Department of the Treasury, the Federal Reserve, and the Securities and Exchange Commission—in that order before any questioning.

I ask each witness to submit his written statement for the record and to summarize that statement in 10 minutes or less.

Second, all witnesses will then be brought back to the witness table for questioning as a panel. That should give us around an hour-and-a-half of questioning.

Third, each member of the subcommittee will have 5 minutes for questioning each round and we will go as many rounds as time permits. But I assure you that we must enforce the 5-minute rule as we proceed.

Now, I ask if other members of the subcommittee do have statements?

Mr. Madigan, do you have a statement?

OPENING STATEMENT OF HON. EDWARD R. MADIGAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. MADIGAN. Mr. Chairman, in view of the number of witnesses that we have and the amount of time that is going to be available to us this morning, I am not going to make a formal opening statement.

I am going to say, though, at the outset of these hearings, that I share your concern that this committee and other committees of the Congress seem to be put in the position periodically, and by periodically I now mean almost semiannually, of monitoring disputes or refereeing disputes, if you will, between the Commodity Futures Trading Commission and the futures trading industry.

I have read this 100-page report of the Commodity Futures Trading Commission which says with regard to the silver problem that the price of silver went up because of factors outside the market, that the price of silver went down because of factors outside the market, and there was no immediate evidence of any manipulation or cornering of the market.

I do not understand, that being the case, why we have had all the publicity that we have had and the problems we have had. I am sure Commissioner Stone is going to explain that to us. I am sure he is also going to explain why three members of his Commission do not agree with his recommendations to this committee and I am looking forward to those explanations.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Madigan.

I recognize Mr. Glickman for a statement.

OPENING STATEMENT OF HON. DAN GLICKMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. GLICKMAN. Thank you, Mr. Chairman.

We are here today to examine whether expanded regulatory powers should be provided to the CFTC and to general oversight provided by the interest and leadership of our Chairman Ed Jones into the commodities market.

It is also incumbent upon us to look at any interest of the other Federal agencies in the regulation of futures markets, particularly in light of suggestions that the Federal Reserve regulate margins on futures contracts.

I have introduced a bill that would give the CFTC standby authority to set margins during emergency situations only. Commissioner Stone favors more expansive authority.

But I am disturbed by the report of divisiveness on the regulatory function of the Commission. I am not sure whether the blame for this falls on the shoulders of the Chairman or anyone of the Commissioners, or whether it is a function of a vast variation of

thought concerning the extent of Government authority over futures markets activities.

I am also worried that the level of cooperation between the Commission and the other appropriate Government agencies leaves much to be desired and may create jurisdictional controversies which could destroy much of the CFTC jurisdiction and give credence to building interest on Capitol Hill to split jurisdiction away from the CFTC.

None of this is helped by the failure of this administration to nominate a competent fifth member to this Commission.

Nonetheless, I continue to feel that the CFTC is best equipped to handle the regulation of futures markets. It has the mechanism in place to continuously monitor the markets and take action if extreme conditions occur. It also allows the orderly introduction of new commodities to be traded, although I have heard some criticism about the inordinate length of time taken by the Commission to rule on such new contracts.

No one can deny that there are unresolved issues with the Commission in the administrative, philosophical, and possibly legislative areas. But a coherent regulatory structure over the futures markets is best served by maintaining that authority exclusively within the CFTC.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

Mr. Richmond?

Mr. Baldus?

Mr. BALDUS. Mr. Chairman, thank you.

I look forward to the testimony. It seems to me that we have producers on the one side of trading, and consumers on the other. I think neither of them have been too satisfied that their best interests have been taken care of. Trading is supposed to regulate sales and make it better, but I think that market regulation leaves something to be desired and I hope we can hear the reasons.

Mr. JONES of Tennessee. Thank you, Mr. Baldus.

Now, I recognize the fact that we have the presence of our ranking member of the full committee, Mr. Wampler, with us. We are delighted you could come, Bill, and do you have any statements you would like to make.

OPENING REMARKS OF HON. WILLIAM C. WAMPLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. WAMPLER. I don't have any statement, Mr. Chairman. I thank you very much.

I want to commend you and our distinguished ranking member, Mr. Madigan, for scheduling these hearings. I have utmost confidence that you will conduct fair and thorough hearings and will report to the full committee your findings and any recommendations you might have to make.

Mr. Chairman, if you will recall, I was not among the enthusiastic supporters of the original legislation that created the Commodity Futures Trading Commission. However, my position has changed somewhat, but I still have reservations about it. I am anxious to hear what the witnesses have to say.

Mr. JONES of Tennessee. Thank you, Mr. Wampler. We appreciate your being with us.

I recognize Mr. Daschle for any statement.

Mr. DASCHLE. Thank you, Mr. Chairman. I have no statement.

Mr. JONES of Tennessee. Mr. Coleman, do you have a statement?

Mr. COLEMAN. Mr. Chairman, I am looking forward to the testimony today to see if there is any light to be shed.

Mr. JONES of Tennessee. Thank you. I hope you stay with us.

I want to recognize another member of the full Agriculture Committee, enthusiast of what we do on Conservation and Credit Subcommittee, Mr. Floyd Fithian of Indiana.

Thank you for being here, Floyd, and we hope you will be able to stay with us today. Do you have any statement you would like to make?

OPENING REMARKS OF HON. FLOYD J. FITHIAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. FITHIAN. Just a word to thank you, and to thank you especially because when we worked on this 2 years ago, we got into many of the technical problems and difficulties of dealing with this. I suspect we are going to continue next year again.

But my real thanks and caution here are that we proceed in such a way as to retain the relationship between commodities and the agriculture world as we have jurisdiction over it. I think it would be a very sorry mistake if the relationship of the commodities to grain, grain dealers, and farmers were ever severed, and there is movement in both the House and the Senate to do just that.

So I add a special commendation to the chairman for holding the hearings. I think it is important we continue to demonstrate responsible and constructive interest in this area.

Mr. JONES of Tennessee. Thank you very much.

Mr. Hance has arrived since we began. Do you have a statement you would like to make?

Any other member I have overlooked?

Thank you, gentlemen.

Our first witnesses are the members of the Commodity Futures Trading Commission: James Stone, Chairman; Read Dunn, David Gartner, and Robert Martin, Commissioners.

They are all seated at the witness table and I suppose, Chairman Stone, you are ready to proceed.

STATEMENTS OF JAMES M. STONE, CHAIRMAN; READ P. DUNN, DAVID G. GARTNER, AND ROBERT L. MARTIN, COMMISSIONERS, COMMODITY FUTURES TRADING COMMISSION

Mr. STONE. Thank you, Mr. Chairman.

Members of the Commission are pleased to be here this morning. As you noted in your opening statement and as I feel is fully appropriate in collegial deliberative bodies, the members of the Commission do hold differing opinions concerning the seriousness of the silver situation this year and what remedial action, if any, is called for to prevent the recurrence.

There is a majority statement of the Commission in which I would concur largely with respect to the facts, but dissent largely with respect to the conclusions, and it was felt by the Commission that it would be best for someone who is in the majority and could answer questions on the statement to present that statement.

Therefore, the Commission has asked that Commissioner Dunn present the majority statement of the Commission. I have a dissenting statement that I could offer, if you wish me to, after that.

Mr. JONES. Do you mean that Commissioner Dunn is going to lead off, then, instead of your statement?

Mr. STONE. If that would be satisfactory to you, Mr. Chairman.

Mr. JONES. Without objection, we will hear Commissioner Dunn, then.

Mr. STONE. Thank you.

STATEMENT OF READ P. DUNN, JR., COMMISSIONER

Mr. DUNN. Thank you, Mr. Chairman.

The Commodity Futures Trading Commission has provided to the subcommittee a detailed report describing activities in the silver futures markets which occurred predominantly from August 1979 through March 1980.

This report should provide members of the subcommittee with a better understanding of the various market conditions which existed during this period as well as the actions taken by the Commission and the commodity exchanges in response to these conditions.

I will not attempt to recount all of these facts here today. Nevertheless, I believe it would be helpful to outline certain aspects of the silver situation for this subcommittee and particularly to explain to the committee why the Commission acted as it did during the period.

Silver futures trading first became subject to Federal regulation in 1975 as a result of Congress enactment of the Commodity Futures Trading Commission Act of 1974. Since 1975, the Commission has exercised oversight of trading in silver futures on the Commodity Exchange, Inc., which we call Comex, and the Board of Trade of the city of Chicago, which we call the CBOT, where the vast majority of silver futures contracts are traded.

The Commission receives daily reports on the positions of participants in silver futures trading who hold 250 contracts. That is the equivalent of 1,250,000 troy ounces or more in any future.

Through its surveillance program, since 1975, the Commission has been informed of silver trading activity by members of the Hunt family and entities in which the Hunt family has a financial interest.

From the middle of 1975 through July 1979 the net silver positions of all Hunt-related accounts on Comex ranged from about 1 to 6 percent of the open interest. The Hunts generally did not make or take delivery of silver on these futures contracts. Rather, after 1976 they liquidated their existing positions and reestablished or rolled over their silver positions into distant months.

In early 1979 the Commission became aware that the Hunts were increasing their long silver futures positions. In July of 1979 a corporate account for International Metals Investment Corp., called IMIC, which the Commission learned was Hunt-related, also began establishing long futures positions on both Comex and CBOT.

In addition, during the first half of 1979 substantial new long positions in silver were being established in accounts carried by ContiCommodity Services, called Conti, a futures commission mer-

chant. Most of these positions were for foreign accounts, principally in Comex December 1979 futures.

By the end of July 1979, silver futures were trading between \$9 and \$10 an ounce. Cash silver was similarly priced. However, beginning in August, the price of silver began a steady upward climb, as did the price of other precious metals.

As of that time—this is a slight correction of the printed copy—the Hunts and the Conti net positions in total had, never comprised more than one-fifth of the total open interest in the silver futures. Nevertheless, the Commission was concerned about the absolute large size of these positions and in early September 1979 the Commission directed its staff to communicate with Comex, CBOT, and the clearing members of the exchanges and certain traders in order to inform them of the Commission's concern that all parties carry out their responsibilities for insuring the integrity of the market.

During September Comex and CBOT exercised their emergency powers and imposed new requirements for trading in silver and also increased margins.

In early September the Commission also issued a special call to determine for whose benefit some of the positions carried in foreign accounts through Conti were held. The Commission also authorized a special call to IMIC which earlier had established substantial long positions. The Commission later learned that the Hunts hold stock in IMIC and that W. H. Hunt is a director of IMIC and participated in IMIC's trading decisions.

At that time, that is September, the primary focus of the Commission's surveillance concern was on the December 1979 Comex future since no substantial concentrations of positions existed in those futures which were to mature in the earlier months.

The price of the maturing silver futures contract rose from approximately \$12 in September to approximately \$16 at the end of October.

In late September and early October, the Commission learned that IMIC and a few of the Conti accounts intended to accept delivery on their long futures positions.

These acquisitions of physical silver increased the Commission's concern. This concern was expressed by certain members of the Commission at a public Commission meeting on October 16, 1979.

Subsequently, both Comex and CBOT took further emergency regulatory actions. The CBOT imposed a 600 contract net position limit on silver futures holdings. Comex increased its original margin requirements from \$20,000 to \$50,000 for all contracts other than bona fide hedge transactions.

Mr. Chairman, I would like to depart from the printed statement here to add one point. In looking over the sequence of events last night, I was struck by the significance of the October developments. October did indeed mark a decisive turning point in the history of these transactions.

It is true that from October the price rose sharply, but it is also true that the volume of trading, the amount of open interest, declined sharply after these restrictions were placed in effect.

Even the size of positions held by the Hunts, the Conti group, and the other major longs began to drop sharply after this time.

But while the total holdings in the futures markets by some of these people, the Hunts, the Conti groups and others were declining sharply, their holdings in the cash or physical market began rising sharply. They crossed about this time in October. In other words, the physical holdings of these groups began to be larger than their futures holdings.

These trends continued, and by the time the price peaked in the latter part of January, the physical holdings of the Hunts and the Conti groups in silver, bullions, and coins was about three-fourths of their total holding; in other words, the futures positions had declined to only about one-fourth of their total holdings of cash and futures.

It is also obvious from reading the papers during this period and, from what we heard, that the Hunts and Conti groups were by no means the only people who were buying and holding bullion, coins, and other forms of silver. I refer to this, what I call the cross point in the story, because I think it is very significant.

Two things: First, the restrictions imposed by the exchanges were beginning to bite and bite hard, not only the position restrictions but the higher margins. The Hunts, themselves, have said in the hearings that after this point it was cheaper to finance physical silver through the financial world, the banks and others, than it was to finance the acquisition through the futures market.

Second, silver was in great demand in comparison to its supply. While we have no means of knowing what the total amount of silver was that was being acquired outside of the futures markets by small and large speculators all over the world, we have reason to believe it was very substantial indeed.

We know that the total amount of cash certificated silver acquired by the Hunts and Conti reached at least something like 180 million ounces which, when viewed against the U.S. commercial consumption, the world mine production of silver, the world consumption of silver, is indeed a very large figure.

If the holdings of others equaled between 25 and 50 percent of what the Hunt and Conti groups owned, the amount of certificated silver being held off in the market becomes very large indeed. There is certainly no question in my mind that it was this siphoning off of silver from the commercial market which put very great pressures on the silver market prices, and that after October it was these pressures in the cash market which were the principal pressures to be found in the futures market.

I will go back to the text.

In response to a Commission special request for information, the Hunts reported to the Commission that the Hunts and IMIC combined owned approximately 26 percent of Comex silver stocks and 62 percent of CBOT stocks for a total ownership of 56 million ounces of certificated silver. In addition, IMIC owned approximately 28 million ounces of noncertificated silver.

As I was saying, these groups were also acquiring very substantial quantities of silver outside of the futures system.

In mid-November the Commission was concerned about a potential squeeze of the December Comex future. However, by the latter part of November a substantial portion of the major long positions in that future were liquidated. In addition, the Commission staff

surveyed the shorts and learned that shorts had sufficient certificated silver and intended to make their required deliveries on the contract. These two factors operated to alleviate the threat of a squeeze in the December futures.

The Commission then concentrated its attention on the February 1980 CBOT contract and the March 1980 Comex contract. By this time, the Hunts had assured both the Commission and the exchanges that they intended to liquidate most of their long positions prior to the delivery month.

The price of silver nearly doubled during the month of December. As the price increases began, the CBOT responded by increasing margin further and by requiring clearing members to file daily reports concerning silver futures positions. The Commission was concerned that the cash and futures position of the Hunts, IMIC, and the Conti group were becoming too large relative to the size of United States and world supplies and consumption, as I was discussing earlier.

The Commission noted that the futures markets were not intended or designed to be a substitute for cash markets for the acquisition of a commodity and that the futures markets and perhaps even the world cash market might no longer be capable of supplying the large quantities of physical silver then being demanded.

Therefore, the Commission decided that some additional action had to be taken as soon as possible. Accordingly, the Commission instructed the Executive Director to arrange a meeting with the senior officers of the exchanges on which silver futures were being traded. That meeting was scheduled for January 8, 1980.

On the evening of January 7, Comex adopted a temporary emergency rule which established reporting requirements and imposed a monthly gross position limit of 500 contracts for the January and February 1980 futures and a net position limit of 2,000 contracts for all futures combined.

Following this action, silver prices declined for 1 day and then continued to move sharply upwards. The Hunts and other large traders continued to acquire, but not entirely through the futures markets, large quantities of silver, as we explained earlier.

By January 21, the spot London silver bullion price had risen to \$49.95. On that date, the Comex delayed the opening of its silver market until the afternoon and exercised its emergency authority to limit trading in all Comex silver contracts to liquidating transactions.

The next morning the CBOT adopted an emergency rule calling for phased liquidation of nearby futures positions. In addition, on February 4, 1980, the Comex raised margin levels to \$60,000 per contract for traders holding more than 250 contracts and to \$75,000 per contract for positions in the spot month.

Following these actions, the price of silver futures declined somewhat and by late February was trading around \$35 per ounce. In early March, silver prices began to fall sharply again from about \$33 on March 7, to \$17 on March 17. Thereafter, prices stabilized again—

Mr. JONES of Tennessee. Mr. Dunn, will you pause for a moment. Can you summarize your statement? You have consumed 10 minutes and I want to hold to the rules if I possibly can.

Mr. DUNN. I am practically through the background statement, Mr. Chairman.

Mr. JONES of Tennessee. It is not going to give us any opportunity to ask any questions if we don't enforce the rules. So if you will summarize

Mr. DUNN. Yes, I can. The remainder of the statement goes into the question of whether additional authority for the Commission is needed at this time.

The view of the majority is that at the present time we do not see the need for additional authority. We think that the Commission's authority under its emergency powers is adequate to permit the Commission to act in almost any conceivable situation, even to establish margins on exchanges.

We discuss the question of margin—the purpose of margins being to assure the performance of the contract—and raise questions as to how, when, and if position limits should be imposed.

With regard to the issue of margin authority, we question whether this is the proper vehicle to use if it should become necessary to limit access to the markets or to limit positions in the market. It is our feeling that if and when such actions are necessary, there are better and more effective ways of achieving those results than by the use of margins. In order for margins to perform their basic function of assuring the performance integrity of the contract, changes in margin levels are required very frequently, and these changes can best be made by the exchanges themselves.

That is the substance of the statement and I would be glad to leave it at that until questions.

Mr. JONES of Tennessee. Thank you, Mr. Dunn.

Mr. DUNN. I assume, Mr. Chairman, that the full statement will be made a part of the record.

Mr. JONES of Tennessee. Without objection, the full statement will become part of the record.

[The prepared statement of Mr. Dunn may be found on p. 166.]

Mr. JONES of Tennessee. I want to observe that Mr. Dunn has consumed 17 minutes.

Now we will go to Mr. Stone, the Chairman of the Commission, and when the red light appears, Mr. Stone, I hope you can summarize as rapidly as possible because it is set on 10 minutes.

STATEMENT OF JAMES M. STONE, CHAIRMAN

Mr. STONE. Yes, Mr. Chairman. Thank you very much, sir.

In what follows I will be speaking only for myself. I think Mr. Dunn's statement on what happened in the silver markets is useful background, and my principal disagreement with the majority position is only with respect to conclusions and recommendations.

My principal conclusion from the events of the last few months is that too much speculation in commodities is an unacceptable threat to our Nation's tightly interwoven financial structure. Large scale speculation in commodities is not in my view a harmless pastime, but rather it is a danger to our economy. I don't think we should let futures markets depart from their economic role in commercial facilitation to become centers of unrestrained speculation.

In my testimony I appended a table which shows how far the markets range in terms of speculative participation, the wheat and corn markets being examples of futures markets which have remained predominantly commercial, while other markets having become predominantly speculative.

The frozen pork belly market is more than 80 percent speculative. Treasury securities are dominated by speculators. And more to the point in today's hearings, the silver market is without question a predominantly speculative market. Open interest on the two major exchanges has averaged at least 80 percent speculative in recent years.

Overwhelmingly speculative markets are of questionable value under any circumstances, but under the price leadership of a few disproportionately large traders, they are natural birthplaces for speculative bubbles.

I believe the situation in silver that we saw this year is a good example of a speculative bubble. There were many factors involved other than the Hunts, some extending beyond the futures markets, but altogether formed what I think can be described as a bubble. And I think it is clear from history that when bubbles break, people get hurt. Bubbles in the past have often preshadowed general economic collapses.

The most commonly examined threat from the silver collapse has been the danger to financial institutions during the last week of March. It is no secret that the Chairman of the Federal Reserve, the Deputy Secretary of the Treasury, the Chairman of the Securities and Exchange Commission, and I virtually ceased all other business for 3 days as we monitored the potential for disastrous ripple effects throughout the economy.

It was feared that the positions of the Hunt family were too large to be liquidated without triggering a round of panic selling. There was a danger that margin calls to other market participants could force additional position reductions and increase the panic. A sudden rush to raise margin funds in the silver market could have caused other markets to experience selling pressure. And, because major banks and brokers had financed the activities of the largest speculators, the effects of any silver margin defaults could have spread rapidly through the securities and banking sectors.

A professor of economics writing recently in *Journal Commerce* wrote as follows in describing the situation:

The crash of the silver market revealed that funds are available for large deals that violate basic canons of finance and that when these deals unravel, the viability of financial markets and institutions can be endangered.

That is his statement. I agree with it. We will never know how close we came to the edge of a general financial panic, but that is an issue I don't think needs to be settled. There was no economic benefit in the craze for silver to justify even a small risk of economic collapse.

The risk of collapse is not the only public cost to the silver bubble. There were adverse implications, not just risk but in fact, for employment, inflation, and for the allocation of credit.

Publicity has been given to how Kodak, the Nation's largest producer of photographic film, was affected. For every \$1 increase in the price of silver, monthly production costs are estimated to

have risen by \$4 million. The voices of smaller businesses need to be heard as well.

Writing to Senator Henry Jackson, the owner of a small printing company in the State of Washington complained that the bubble "just about ruined me. It will take 6 to 12 months to catch up financially."

Writing to Congresswoman Mikulski, a Baltimore woman tells of how her silversmith husband was laid off by his employer after 32 years of employment. She writes: "A silver craftsman is an American worker as much as his counterpart in the automobile industry." She goes on to talk about thousands of people being victims in terms of job loss.

Well, those figures are correct. According to the Department of Labor's Bureau of Labor Statistics, 6,000 jobs were lost in the jewelry, silverware, and plateware manufacturing industries between November 1979 and February 1980.

Inflation, too, was affected. The Bureau of Labor Statistics reported on February 15 that:

The Producer Price Index for intermediate materials, supplies and components rose a seasonally adjusted 2.8 percent from December to January, the largest monthly rise since August, 1974.

The report goes on to say that: "A 94.7 percent rise of prices for precious metals accounted for one quarter of the increase in the total intermediate materials index." At the finished goods level, a 1.6 percent monthly increase was recorded. The Bureau attributes much of the acceleration to steep price increases for household flatware and precious metal products.

The increases were by no means confined to luxury items. The price of medical X-ray film, an expense shared by every economic stratum, jumped 93 percent. Phototypesetting paper used in newspaper printing rose in cost by 75 percent. The full inflationary effects of the silver bubble on consumers are hard to measure. In an indexed economy, they may be even harder to erase. Once a cost has been echoed through all of the elements of our intricate pricing system, even a decline in the primary price cannot necessarily undo the damage.

Credit availability as well has been affected by the silver bubble. The largest silver speculators held their enormous positions with the aid of hundreds of millions of dollars in borrowed money. Banks, too strapped for funds to lend for productive uses, were only too willing to finance speculation in commodities; and I doubt that the Hunts were the only silver market participants to borrow money.

Other people had to borrow money for variation margin, undoubtedly, as the price rose and again as it fell.

The Hunts were not, as some people have suggested, the only victims of what happened in silver. The Hunts can afford to live with inflation. They didn't lose their jobs and haven't been denied credit. Before a Senate committee they testified they are not even sure whether they made or lost money on their silver speculation.

The market did not, as some people suggest, take care of all the problems. The markets may have indeed eventually restored a more sensible price than that prevailing in January, but the boom and bust was far from costless.

I think the major lesson may be this: When society has chosen to sanction other forms of gambling, it has wisely and consistently adhered to the principle that it should be insulated from all genuine productive activity. Excessive speculation in silver provides a good example of the harm that can come when this principle is violated.

I think that a short list of corrective measures taken together and taken now that we are not in the midst of a panic would go far to diminish the likelihood of recurrence of a bubble. I am pleased to see this subcommittee study legislation on the most important of these.

Low speculative markets are probably the single strongest inducement to widespread noncommercial use of futures markets. Traditionally, the exchanges have set speculative margins low, often a small fraction of the value of the contract. In the silver market, for example, prior to September of last year, margins were generally lower than 5 percent. Accordingly, when silver was selling at roughly \$10 an ounce, the margin required was only 30 cents an ounce. Each time the price rose another 30 cents, the value of the speculator's initial investment was doubled.

The arguments for commodity margin control are similar in some respects to those offered with respect to the stock market following the great crash of 1929. This is the case despite the fact that margins in the two areas are legally quite distinct. The distinctions should not be cited to obscure some important operational similarities between commodities and securities margins.

One important common element is that each serves as a threshold determinant for customers considering entry into the market. The initial decision on market entry and the quantitative decision on how large a position to take may in large measure depend on the relationship between available speculative cash and the amount of margin required. A second common element is the potential role for margin in the acceleration of sudden price fluctuations. When margin deposits are low, price movements may generate sufficient calls for additional deposits that customer decisions about account maintenance are heavily influenced by ability to meet the calls. A market characterized by low margins is a market vulnerable to chain reaction price movements which may become self-sustaining and tend to distort fundamental price formation.

Congress has stated in our enabling act that excessive speculation can be a burden on valuable interstate commerce. I think it follows that it is thus appropriate to limit speculative activities to a level conducive to useful commerce.

There is little dispute that margins are among the most powerful tools for influencing market participation. Margins can help to maintain a proper balance between speculation and hedging activities. The need to protect markets from chain reaction price movements is similarly met by an ongoing and effective program of minimum margin requirements.

Once the bubble is formed, however, there is no tool that lances it without harmful side effects. Margin authority is better as an element of prevention than as a cure.

The second step we should take to reduce the risk of a recurrence does not require congressional action. It involves the imposition of speculative position limits.

My statement describes the advantages of speculative position limits and some of the factors we should take into account as we consider the imposition of speculative position limits. And I should note that the Commission has referred to staff an assignment to study and develop for our consideration a program which would establish limits of one of the types that I think are required.

My third and final recommendation, which I understand will not be the focus this morning, concerns the behavior of credit institutions. I think it is imperative that restrictions be placed on the ability of banks and commission houses to finance their customers' speculative activities.

Since the Great Depression, banks and brokers have been prohibited from lending money to meet legally set margins on securities. There is no reason for the disparity in commodities, in which no such limit exists, to continue.

Had banks and brokers not been endangered by the potential chain reaction last March, the public concern over silver would have been vastly diminished.

I take no pleasure in appearing before this committee as a Cassandra who warns of impending doom. But I do wish to be unambiguous in my message. Unconstrained speculation in commodities may be extremely attractive to an industry which depends upon trading volume. It may be attractive for the largest of market participants, those enjoying special access to information or market dominant size. We need to look, though, with extreme care at whether it is less healthy, as I expect it is, for the small farmer, the small businessman, the consuming public or the fabric of an economy as a whole.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Stone may be found on p. 177.]

Mr. JONES of Tennessee. Thank you very much, Chairman Stone, and we will be calling you back at a later date for questioning.

Now we will hear Commissioner Gartner who also has a statement, I believe.

STATEMENT OF DAVID GARTNER, COMMISSIONER

Mr. GARTNER. Mr. Chairman, Commissioner Dunn spoke for the majority, of which I am a part, but I do have a few remarks to make that are germane in a broad sense to the subject under discussion today, namely, what happened recently in the silver market, and if any legislation should be enacted to prevent a recurrence.

Mr. Chairman, before the Congress rushes into any new legislation, which often raises new problems as it tries to solve others, it is vital that we consider whether government really protects best. I think not.

No one in this country ever should have to apologize for being a capitalist. Free enterprise, not a restrictive government, has been responsible for the success of this country.

Government, of course, must provide a proper atmosphere for business to flourish. But it must not take from it the responsibility

for making its own life and death decisions. Government should not enact regulations, nor should it take actions that lull business into making imprudent decisions such as overextending itself as in the recent case of some brokerage houses, with an idea that each business is so important to the life of the economy that the Federal Government can't let it fail.

Does the Federal Government have the specialized know-how to successfully run every industry in this country? Does it have the funds to bail out each industry that subsequently nears failure, throwing people out of work, and sending the economy into a tailspin? I think not.

Mr. Chairman, I spent more than 18 years on this Hill before I came to the CFTC. This Hill gave me my education and Hubert Humphrey was my teacher. "A public office," he fervently believed, "is a public trust."

I believe my public trust as a regulator demands that I look beyond the narrow aim of trying to amass power for our agency or more power for the Federal Government. I believe that it is my duty—indeed the duty of each of us as public servants—to look to the good of the United States of America as our guide in deciding how to handle the questions of new legislation in futures trading.

I think we are playing a cruel joke on the American public if we pretend that we can protect it from bad business decisions or ultimately from its own ignorance.

As a responsible public servant, I must challenge business to enter a new age of leadership, making mature, responsible decisions on a day-to-day basis without subconsciously depending on a government bail-out.

The profit motive, with its accompanying risk of loss, is still the best incentive for making responsible business decisions. And an educated public is the best protection against its being fleeced. But this cannot take place without government acknowledging its finite capabilities and slowing its hell-bent pace of regulating every phase of American life as though it would create a totally risk-free society. As Americans we must all assume more responsibility for our own destiny.

Consequently, Mr. Chairman, I believe that very sober, careful study needs to be made of all the facts present in the situation surrounding the rise and fall of silver prices before any changes in regulatory authority are made. Change at this time would be inadvisable and indeed might well be damaging over the long haul.

I thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Gartner.

Mr. MARTIN, do you have any statement you would like to make?

Mr. MARTIN. I have none. That should draw applause.

Mr. JONES of Tennessee. Thank you, gentlemen, and if you will stand by, we will call you at a later time for questioning.

The next witness is from the U.S. Department of Treasury, the Deputy Secretary, the Honorable Robert Carswell.

If you have some people with you you would like to bring to the witness table, please do so.

STATEMENT OF ROBERT CARSWELL, DEPUTY SECRETARY,
DEPARTMENT OF THE TREASURY

Mr. CARSWELL. Thank you, Mr. Chairman.

I welcome the opportunity to discuss the Treasury's role in the recent developments in the commodity futures markets as Treasury shares this committee's concern about orderly markets.

The Treasury Department has no specific statutory authority over any market for commodities or commodity futures or any participants in those markets.

As this committee is aware, the Treasury's initial concern with the rapidly developing futures markets centered on the potential impact such markets might have on Treasury's debt management flexibility and on the underlying cash market for Government securities.

However, the recent developments in the market for silver futures and the rapid proliferation of new futures, forwards and options contracts have raised broad issues about the stability and orderly development of the whole of these markets.

Historically, Treasury has had an interest in the precious metals markets. As the custodian of the Nation's reserves of gold and the Cabinet agency responsible for international monetary policy, the Treasury closely and continually monitors the markets for gold. Treasury was similarly concerned with the silver markets, but by 1970 silver had been eliminated from our circulating coinage and most of the Nation's then remaining silver reserve had been sold in the market or transferred to the General Service's Administration.

Treasury purchases copper for coinage and has conducted a gold auction program since May 1978, but otherwise is not directly involved in transactions relating to commodities.

In the Futures Act of 1978, Treasury was given an advisory role with respect to futures in Government and Government-guaranteed securities, but the act did not give the Treasury any regulatory authority in the area.

Because Treasury engages in the extensive monitoring of, and operations in, the foreign exchange markets, it also closely watches the markets for futures involving foreign currencies, but again, it has no statutory responsibility for that area.

In general, the Treasury's position is one of watching the futures market at the moment and the Secretary of the Treasury trying to fulfill his function as the chief financial officer of the country to insure that financial markets are functioning efficiently but without any articulate regulatory authority concerning any of these futures markets.

My statement next proceeds, Mr. Chairman, with a description of what the Treasury did in the silver area during the recent crisis. I think Chairman Stone already summarized it for you.

I spent 3 days, starting on March 26, monitoring it as closely as we could in the Department to be sure that there were not going to be any unacceptable side effects in the other financial markets. As far as we know, there were none, and hence we did not ask the CFTC or any exchange, to take any action in this area.

I would request that my statement be published in the record on this subject, but I don't think it is necessary to go through it with you here.

Mr. JONES of Tennessee. Without objection, it will become a part of the record.

[The prepared statement of Mr. Carswell may be found on p. 190.]

Mr. CARSWELL. As to the commodity markets and the commodity futures market themselves, the Commission has been concerned for some time that speculative trading in those markets may well have contributed to inflation directly, and just as importantly, to inflationary expectations.

For example, precious metals accounted for about .5 percent of the 1.6 percent increase in the Producers Price Index in January. The increases feed through the production process and result in price increases in some products which are not necessarily reduced when commodity prices themselves go down.

Furthermore, these price increases can result in subsequent increases in wage and price contracts tied to the price indices, further exacerbating inflation.

It is unrealistic to expect that any market will operate perfectly, but when leveraged speculation based on inflationary expectations results in extraordinarily wide swings or the fear of a corner unduly raises prices, the effect on the whole economy is unnecessarily disruptive. Hence from the overall standpoint of moderating inflation, any measures that would tend to insure that the markets operate in an orderly and efficient fashion would be useful.

An additional concern is that when any market operates in an aberrational fashion, that can have disruptive effects in other markets. And that was the fear during the silver episode.

Finally, Treasury remains concerned about the proliferation generally of new contracts involving future delivery or that refer to future market prices of financial instruments, currencies or indices. These have taken the form of forward contracts, contracts for future delivery or performance and of options on both types of contracts. Some of these markets are just getting started; others have grown very rapidly in the last 2 years. For instance, the 3-month Treasury bill futures contract volume exceeds the cash market in that area, the level of trading now being at about \$2 trillion annually.

As I mentioned to this committee in February, rapid developments in these markets and explosive growth have created considerable uncertainties and placed a heavy and increasing burden on the CFTC and its responsibilities for governance. It has happened so quickly that the full significance is not yet known. Our concerns with these markets have not diminished and, as I stated in February, we are uncertain that the present regulatory structure is able to cope with this growth and all its attendant potential problems.

Although we are as close as any Federal agency to these markets, we do not fully understand them, who the participants are, what they are doing, or what economic purpose is being served. We are doubtful that anyone knows the answers to these questions and have therefore suggested that developments be carefully monitored and that new contracts not be liberally designated.

In this circumstance, the Treasury, the Federal Reserve Board and the Securities and Exchange Commission have formed a working group and with the help of the CFTC we intend to evaluate

various aspects of this complex situation and arrive at conclusions as to what, if any, legislative action would be appropriate. The group has already met several times and consulted with various persons outside of the executive branch. The same group will shortly complete a study conducted over the past 3 months of the GNMA forward contract market. That study will provide some suggestions for dealing with some of the problems in that area.

You have also asked for our views on several specific proposals for legislation, the possible need for additional regulatory authority over margins and speculative position limits. While we are not in a position to make definite recommendations at this time, I would like to make a few brief comments.

Margins play a role in the futures markets different from their role in the cash markets for equities and debt instruments. Unlike the cash market, where margin determines the level of credit extended to pay for securities, in the futures market, margins act as a performance bond for future payments. Furthermore, in the futures area, there is an additional difference between the initial margin, or earnest money, and the maintenance margin which serves to assure that contracts are marked to market by daily cash settlement of gains and losses.

Easy analogies are likely to be deceptive. It is clear to us—after relatively brief study—that the design of margins whether to regulate credit or to assure performance, may be subject to quite different considerations if a tangible commodity is involved—as opposed to a financial future.

Similarly, the necessity or desirability of position limits may also turn on the type of market involved. This is not to say that a revised regulatory scheme for margins and position limits may not be desirable, but the construction of a new system should take account of the very different basic markets involved and the likely evolution of these markets. Before making any legislative proposal, or supporting any proposal, we believe it is essential that the markets and the regulatory processes be properly analyzed. We are proceeding with that task.

These are large, complex and important issues. There is a relationship between the immediate concerns arising out of developments in the silver market and those being addressed by a number of other regulatory bodies and congressional committees. The concerns in the futures area are closely related to those in the forward market area and the options markets. In the options area regulatory jurisdiction is split between the SEC and the CFTC with some areas remaining unregulated. Both the securities and the commodities industries are proposing and planning increases in options trading.

We would suggest that a piecemeal approach, without an understanding of the full implication of actions, might well confound rather than facilitate resolution of the challenges facing these markets.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Carswell, and we will call you back in a few moments.

Our next witness is Mr. Paul Volcker, Chairman of the Federal Reserve Board.

Mr. Volcker, thank you for coming.

STATEMENT OF PAUL A. VOLCKER, CHAIRMAN, FEDERAL RESERVE BOARD

Mr. VOLCKER. I will read portions of my statement, if I may, Mr. Chairman. Some of it duplicates much of what Mr. Carswell has already said.

I am pleased to be here today to discuss with your subcommittee some of my impressions and reactions to the recent chain of events in the silver market, with emphasis on its implications for public policy.

Even now, however, I am not satisfied that we in the Federal Reserve and others in appropriate Government agencies have fully digested all of the facts and circumstances that threatened a few sizable financial institutions and the financial markets generally. But, it is clear to me that that episode does, in an all too vivid way, raise important questions about the structure and regulation of futures and commodities markets. We intend to pursue those questions as quickly and as dispassionately as we can, looking toward recommendations for Government and private actions.

The Federal Reserve does not have direct statutory or regulatory authority over any commodity or financial futures markets. We do have a continuing interest in the performance and functioning of those markets. For example, to the extent the price trends of those markets or segments of those markets radically depart, for whatever reasons, from general price movements, as was the case with gold, silver, and other commodities during late 1979 and early 1980, they can directly and indirectly fuel inflation and inflationary expectations.

The Federal Reserve's general interest in these markets also stems from its responsibilities for promoting the efficient and effective functioning of the financial markets. That interest is obviously more pointed in certain interbank and Government securities markets, but financial markets in the United States and around the world have become integrated to the point where it is very difficult, as a practical matter, to segregate one market or one institution from others.

For example, some of the institutions with the greatest exposure in the silver situation had far-flung activities in many other markets. Had one of those institutions become insolvent, the problem would have quickly spread to other markets, many of which are far removed from silver. Because of the interdependence of our financial markets, the Central Bank must be prepared, as in the commercial paper crisis surrounding the bankruptcy of Penn Central in 1970, to take appropriate steps to insure the continued viability and integrity of the markets, particularly in times of stress. To fulfill this function, the Federal Reserve must have at least a general awareness of trends and developments in all sectors of the financial markets.

Finally, the Federal Reserve has a direct and immediate interest in the extent to which credit is used to finance transactions in financial markets. That interest can take any of several forms, including a concern about credit finance speculation, a concern about the diversion of credit from more productive uses, or a con-

cern that an excessive use of credit for these purposes can ultimately threaten the safety and soundness of individual financial institutions. And, in the recent silver situation, it would seem that, at least to a degree, all of these areas of concern were present.

Looked at from any or all of these vantage points, or from a more encompassing perception of the national interest, it seems clear that there is need for a thoroughgoing study to determine the kinds of legislative or regulatory remedies that are required to check potential abuses or excesses in these markets.

I have no firm view at this time as to specific actions that should be taken; I do have strong opinions about the types of questions that need to be examined in order to make decisions intelligently and productively.

Futures markets are inexorably tied to an underlying asset that trades actively in cash or spot markets, not just here in the United States but around the world. These markets, whether viewed from the perspective of the relationship of the spot price to the futures price, or from the perspective of the London price to the New York price, are highly interdependent, and that interdependence is a reality which must weigh heavily in our deliberations as to the appropriate regulatory framework for the future. At the extreme, for example, we must recognize that excessive regulation may simply work to drive activity off the organized exchanges or offshore where the threat of abuse to the detriment of our own investors and institutions will be increased.

At this point, I am tentatively inclined to the view that all forward and futures instruments should not be treated alike. More specifically, I believe it is possible to distinguish financial futures from other forward-type instruments and that such a distinction may be appropriate from the viewpoint of public policy.

Certainly, futures in Treasury securities, foreign exchange, and perhaps gold and silver to name a few, do have characteristics, including low costs of transportation and storage in proportion to value, that distinguish these instruments from futures in wheat or other agricultural products. That distinction is not quite the same, but it has some common ground with the distinction that Chairman Stone made about markets that are heavily dominated by speculative trading rather than commercial trading. Financial futures, moreover, are of more direct and immediate interest to the Treasury and the Federal Reserve than are traditional agricultural futures, since they obviously have more direct potential for influencing developments in financial markets and markets for international exchange.

Any consideration of possible changes in the regulation of futures markets must, of course, take into consideration the whole question of the form and amount of margins. In my statement, Mr. Chairman, I review some of the considerations with respect to margins.

Mr. Carswell has already touched upon many of those questions, so perhaps I can skip over reading that part of the statement that does raise some questions about the nature of the present arrangements—whether they are fully adequate and what the public interest may be in more direct surveillance and more direct regulation by a governmental body.

That is an area that seems to me to clearly deserve examination, but when one considers the range of questions concerned with margins, I set those forward as illustrative and not exhaustive, to raise questions rather than to answer them, and I think there are a number of other questions that need to be examined—for example, the potential use of position limits, the nature of surveillance activities across futures exchanges and into the cash market, among other questions—before reasoned judgment can be made about the nature of the regulatory measures that might be needed in this area. It seems to me that only when we have answered those questions will we be in a position to judge effectively how any new regulations can best be administered.

There are several Government agencies, including the CFTC, the SEC, the Treasury and the Federal Reserve that have a natural interest in at least some segments of these markets. That raises a question of where the authority for regulation might be placed. We in the Federal Reserve, as Mr. Carswell has just indicated, have, in cooperation with other agencies, undertaken a broad-based study of these and related questions, and I fully expect that the primary result of that effort will be a set of legislative recommendations that would be submitted to the Congress. That effort will take some time, but I hope not much time.

In concluding, let me make a final observation. I am fully aware that some would argue that the recent episode in the silver markets should not be cause for concern. This position appears to be based on the point that, in the final analysis, the situation worked itself out without major and permanent damage. There may be something to that assessment, but from my vantage point it was simply too close a call to permit us to take the liberty of a business-as-usual attitude.

Thank you.

Mr. JONES OF Tennessee. Thank you very much, Mr. Volcker.

Without objection, your entire statement will become a part of the record.

[The prepared statement of Mr. Volcker may be found on p. 197.]

Mr. JONES OF Tennessee. Mr. Pollack, Commissioner of the Securities and Exchange Commission, is our next witness.

Mr. GLICKMAN. Mr. Chairman, I might just say that this gentleman who is speaking used to be my employer at the Securities and Exchange Commission. He is a very talented gentleman.

STATEMENT OF IRVING M. POLLACK, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

Mr. POLLACK. Thank you, Mr. Glickman.

Mr. Chairman and members of the subcommittee, I have a very short statement but if you will put the full statement in I can make it even shorter.

Mr. JONES OF Tennessee. Without objection, Mr. Pollack, we will be glad to do that.

[The prepared statement of Mr. Pollack and the attachments may be found on p. 204.]

Mr. POLLACK. The events in the silver futures market have underscored the sensitive nature of this country's organized securities

markets and futures markets, and the close interrelationship between those markets.

Since the precipitous decline in silver prices on March 26 and 27, the Commission has closely monitored the financial condition of broker-dealer firms affected by that trading.

In addition, the Commission has begun an inquiry into circumstances surrounding the silver market break insofar as they may have impacted on the securities industry and, in this regard, is coordinating with the CFTC and other interested agencies to ensure that our inquiry proceeds expeditiously and avoids unnecessary duplication of regulatory effort.

In previous testimony Chairman Williams of the SEC was asked for his comments on possible legislative changes.

At that time, he suggested, and I repeat here, that the Congress should provide the Board of Governors of the Federal Reserve System with the authority to adopt margin requirements for all futures trading which would be comparable to the authority that the Board exercises now over equity securities and options on those securities.

Our view is that the extension of credit to a customer writing an uncovered put or call securities option which is now subject to the Board of Governors' margin regulations, is functionally similar to the good faith deposit made by one who sells a futures contract, which is not subject to the Board's requirements.

Authority to regulate the amount of credit which may be extended in futures trading will provide the Board of Governors with an effective tool to curb excessive speculation in that market, and to channel investment capital into more productive areas. Another important result would be the protection of investors, particularly small investors, from excessive risks incurred by trading upon little or no margin.

In addition to the extension of margin authority to the Board, a number of suggestions have been made to enhance the authority of the Commodity Futures Trading Commission under the Commodity Exchange Act. While I am not an expert in these matters, it would appear useful to provide the CFTC with whatever additional authority may be needed to enable that agency to obtain full and accurate reports concerning cash market trading activity.

In light of some of the misconceptions that have appeared recently, I want to make clear that the SEC does not seek any regulatory responsibility over trading in agricultural or other tangible commodities or futures on those commodities. This has been our position in the past and continues to be our position today.

The Commission, however, does have a serious interest in ensuring that the fairness and orderliness of the securities market and the efficient allocation of investment capital are not impaired by disruptions in the futures market. In this regard, the Commission is actively considering whether its net capital rules, and other financial responsibility rules, should be revised to shield more effectively the securities activities of broker-dealers from risks they may incur in connection with their commodity futures trading.

Thank you, Mr. Chairman and members of the subcommittee.
Mr. JONES of Tennessee. Thank you very much, Mr. Pollack.

Now, if you gentlemen who have been heard this morning will come back to the witness table, we will move as fast as possible.

I want to say to you that I know that you are busy, each of you. We will move this as expeditiously as possible, but at the same time I must remind you that the subcommittee is also busy.

Each subcommittee member, if you were not here when we announced the ground rules, will be allocated 5 minutes of questioning at a time.

If we do not finish with the questioning and you want to go around again, we will do that also.

The chairman is going to lead off with the first set of questions, and I will yield to Mr. Glickman, then to Mr. Madigan, and then we will do it in that order until we have gone around the committee table.

Mr. Dunn, I have a question or two that I would like to ask you. Is the delivery period squeeze a serious problem in futures trading?

Mr. DUNN. Yes. The delivery period is always a most difficult period in any futures contract, and when the squeezes do occur they normally occur during the delivery period or immediately prior, to it.

Mr. JONES of Tennessee. How often are squeezes usually attempted?

Mr. DUNN. Not too often, Mr. Chairman. I don't have any record.

Mr. JONES of Tennessee. Then, finally, who is hurt most by the squeeze?

Mr. DUNN. First, I think the institution, the futures market, is what is hurt mostly, because—

Mr. JONES of Tennessee. Would you be a little more specific as to who you are talking about.

Mr. DUNN. I mean the system. I think you could say that everybody that benefits from the system—producers, merchants, and consumers—gets hurt somewhat when it isn't functioning properly. Normally, the system results in a reduction in distribution costs and these benefits are shared by consumers and producers.

The extent of the hurt varies, of course, to the extent of the participation.

Mr. JONES of Tennessee. Was there any evidence of a delivery period squeeze in silver futures trading between the months of August 1979 and February 1980?

Mr. DUNN. Evidence is a difficult word, Mr. Chairman. We were concerned about the possibility of squeeze on several occasions, particularly during the deliveries and then again during the February-March periods.

It's for this reason that we were monitoring those markets very closely, talking with the exchanges constantly, and talking with both the longs and the shorts to determine their intentions, trying to determine whether those who were on the short side of the market and were going to stand for delivery did indeed have the silver to deliver.

We concluded each time that those who were standing for delivery on the short side would be able to make delivery.

Mr. JONES of Tennessee. Then finally to you, Mr. Dunn, what are the most effective tools available to the CFTC and the exchanges for preventing delivery period squeeze?

Mr. DUNN. There are a number of tools.

The adjustment of margins is most often used by the exchanges to prevent delivery problems.

The possibility of a squeeze occurs when you have a tight supply. When that occurs, prices are usually high and markets are volatile. To protect the contracts, exchanges usually raise margins in these periods.

The use of position limits and, of course, jawboning tactics are also employed by the exchanges. Increased margins and limits on positions have also been employed by the CFTC under its emergency powers on occasion.

Mr. JONES of Tennessee. Mr. Stone, Mr. Dunn has alluded to position limits. Would the imposition of regularly prescribed delivery period position limits, as recommended by Dr. Hefner in his report, be a practical way to prevent squeeze?

Mr. STONE. I think it's important to consider two different purposes of position limits. One is to reduce the possibility of a delivery period squeeze and the other is to prevent the formation of positions so large that they become an impediment to free markets.

A delivery period limitation would not, for example, have been the appropriate sort of limit if we had wished to keep the Hunts' position in silver smaller than they were.

In my view a strong argument could be made for both kinds of speculative position limits, and, with respect to the delivery period, it might have to be that those limits would apply to hedgers as well.

Mr. JONES of Tennessee. Are special emergency limits applied to reduce traders' positions during the delivery period an effective means to deal with threatened manipulation?

Mr. STONE. They are certainly among the means that needs to be considered, but I think that in any situation in which a squeeze has been detected as a serious possibility is one that has to be examined very much on its own merits. At times it may be appropriate to order specific reductions of positions.

At times it may be necessary to close a market. Margins could be used as a tool. There are a number of tools, and I think that the facts of each particular situation will dictate what the right tool is.

Mr. JONES of Tennessee. Thank you, Chairman Stone.

My time has expired and I yield 5 minutes to Mr. Glickman.

Mr. GLICKMAN. Thank you, Mr. Chairman. I appreciate all your testimony. I would like to reiterate my comment that I made before that the publicity about the animosity between the members and the Commission is not doing the Commission any good, is not doing your regulatory authority any good and is not building confidence by the public, and I would again say I make that comment for the record.

Mr. Volcker, you appear to be a bit ambiguous about margin requirements, and I have read your testimony, and I want to know basically do you believe that giving the Fed margin authority over futures is a good or a negative legislative purpose, and No. 2, do you believe that if margins are provided on futures, whether there should be bifurcated jurisdiction and CFTC should have that authority?

Mr. VOLCKER. I think there are two separate questions here. One is whether the margin already exists some place in the Government.

Mr. GLICKMAN. Right.

Mr. VOLCKER. And second, whether it is a good idea that the Federal Reserve should have the authority. I am not about to answer either of those questions in any definitive way pending the study that we have underway; these issues will be one focus of that study.

As I indicate in a portion of the statement that I did not read I don't think margin requirements are quite the same in these futures markets as they are in the stock market. In the stock market you buy the security; you have to raise some cash; you may raise it by borrowing with the margin requirement limiting the amount you can borrow.

In the futures case you don't have to borrow; you don't have to make a payment initially other than the initial margin; the margin requirement is a kind of performance bond.

However, margin requirements can certainly limit speculative activity. The two questions that arise in that connection—and these are the areas where I would like to do some more thinking—are: How do you impose the margin requirement without unduly raising the cost of the legitimate operator in the market, so to speak; and, do you drive people off the organized market and into unorganized market—there was some evidence of that in the silver episode—and end up weakening the situation rather than strengthening?

As to the question of whether the Federal Reserve should have the authority, I shrink from bringing the Federal Reserve into detailed, day to day concerns, into all the complexity of the many commodity markets. But, if one thought of perhaps a stand-by authority, I don't exclude the possibility that margin requirements that might be imposed either continuously or at specific points of time, aimed at the general speculative problem, may be suitable for the Federal Reserve; I have an open mind on the question.

Mr. GLICKMAN. You don't have any definitive comments whether the CFTC might have some of that?

Mr. VOLCKER. That is obviously a possibility.

Mr. GLICKMAN. Thank you. I would like to ask Mr. Stone and/or Mr. Dunn, as you know I have introduced a bill that would give you standby margin authority under what I call emergency or close to emergency circumstances.

No. 1, there is some confusion about what authority you currently have. Do you have such authority? Is it limited to emergency circumstances? Is it for all commodities, and do you believe that you have the authority to use it?

Mr. STONE. It is my view that in an officially declared emergency we do have margin authority over any commodity that we regulate, but that our margin authority extends only to those declared emergencies.

Mr. GLICKMAN. Is that a shared view of the Commission?

Mr. DUNN. Yes; it is.

Mr. GLICKMAN. Because you have only used it once, I believe, in your history?

Mr. DUNN. That is correct.

Mr. GLICKMAN. My bill would open that emergency a bit. I finally ask the question about the increasing margins. In your statement, Mr. Stone, you say that "margins serve as a threshold determinant for a customer considering entry into the market."

Raising margins might keep small investors out of the market, perhaps bona fide hedgers, small investors in the agricultural markets, while still permitting large speculators such as the Hunts to remain active. I wonder if you might comment on this point as well as the other members of the Commission?

Mr. STONE. Yes, sir. The change that I have suggested would allow speculative margins to be set. I do not think that there is a strong case for raising the margins for small hedgers, and I would not recommend that that be done.

With respect to the question of whether it would affect large participants, I think that it would affect large participants as well as small ones.

When the margin was close to 5 percent in silver, a large participant was able to take a massive position that might have been extremely attractive to him, and which he might not have wished to take if the margin was higher. I think that higher margins would affect small and large participants alike, but I also believe that speculative position limits are the stronger tool to prevent the specific actions that the Hunts—

Mr. GLICKMAN. You have that authority on speculative positions?

Mr. STONE. Yes, I believe we do.

Mr. GLICKMAN. You believe?

Mr. STONE. Yes, we do.

The reason I said I believe we do is that there is some hesitation in my mind about asserting that the use of our tools would be entirely efficacious, given the ability of a large speculator to set up straw accounts, and hide his activities, and therefore appear to be under the limits when in fact he is over them.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman. I yield 5 minutes to the ranking member of the subcommittee, Mr. Madigan.

Mr. MADIGAN. Thank you, Mr. Chairman.

Commissioner Martin, because you did not make an opening statement, I would like to get you in the record here a little bit if I may.

Earlier I alluded to this report prepared at the request of a Senate subcommittee by the Commission concerning recent developments in the silver futures market. In reading that report, and I would quote it now for you in substance: "Silver prices went up because of inflation, because of a decline in the value of the dollar, because of the situation in Iran, because of the situation in Afghanistan." Am I quoting the report correctly to the best of your recollection?

Mr. MARTIN. I believe you are, sir.

Mr. MADIGAN. Later in the report it says that silver prices went down because of an increase in the production of silver, because of silver users finding substitutes for silver, because of the dollar improving in world markets.

Did I again quote the report correctly?

Mr. MARTIN. I am not sure, but I would augment that just a touch if I may, if I could. I am not sure of discovery of substitutes, but an awful lot of silver came out of cupboards, and an awful lot of people, cab drivers, et cetera, who normally are not aware of commodity prices all of a sudden became aware of silver prices, and a great deal of household silver came on the market which added to the supply.

Certainly the strengthening of the dollar and one other thing I would add is the cost of carrying money. The interest cost had much to do then with the attrition in someone's ability to carry his position.

Mr. MADIGAN. If I understood Commissioner Dunn's statement and Commissioner Dunn, I would invite you to correct me if I misquote you at this point, but, as I understood your statement, the board of governors of the two exchanges in Chicago and New York increasing margin requirements also had a depressing effect upon the price of silver. Did I quote you correctly?

Mr. DUNN. I think increasing margins and use of position limits changed the course of the action from one of steadily increasing positions in the futures markets to a decrease of positions in the futures markets, and an increase of position in the physical markets. Consequently, the futures markets became, I think, less and less a factor, and the cash market became more and more a factor.

Mr. MADIGAN. Is it also correct that for almost all of the period of time with which we are concerning ourselves, that the cash market for silver was as high, nearly as high as or higher than the futures market?

Mr. DUNN. Yes, sir. The relationship of the cash market as judged by cash market quotations in New York, London, Zurich, Tokyo, all over the world, was extremely close during this entire period.

Mr. MADIGAN. So, to say that the futures market or futures trading is somehow responsible for inflation, might it not be more correct to say that the futures market, rather than being responsible for was instead reflecting what was going on in silver?

Mr. DUNN. I feel very strongly that the futures market does not and cannot make prices. The futures market reflects prices. It reflects and focuses into one single price, the supply and demand factor in the cash market around the world.

Mr. MADIGAN. I would like to go back to you again, Mr. Martin, do I quote this report correctly if I say that the Commission's position is that there was no violation of law, no manipulation, no corner, no squeeze? Did I quote the report correctly?

Mr. MARTIN. I am reminded by my general counsel that we have an ongoing investigation now, but you do quote the report correctly, yes.

Mr. MADIGAN. And if there had been evidence of any of those things, then the Commission would have, and does have, in the light of evidence of that kind, the authority to set limits on speculative contracts.

Mr. MARTIN. We do, and we have the responsibility to act. If there had in fact or if we suspected at that time a manipulation, we should have acted.

Mr. MADIGAN. Chairman Volcker, if I may ask you one question.

I have read in the papers where you attended a meeting in Florida of some bankers who were apparently together for the purpose of discussing financing of some means to get the Hunts out of the trouble that they were in. Is it correct that you were at such a meeting?

Mr. VOLCKER. I was at a meeting, for a limited period of time, with some bankers who were discussing a credit. I don't know whether it was instigated by the creditors or by the Hunts; it was instigated by both, I suppose.

Mr. MADIGAN. You were there twice as I read the story. You were there and then you left and came back in the early morning hours in your pajamas, as I read the story.

Mr. VOLCKER. I was not in my pajamas. There was only one meeting in Boca Raton, which was indeed very late at night. I simply joined the meeting, and they told me what their decision was after they had evaluated it, basically.

Mr. MADIGAN. You only came into it once?

Mr. VOLCKER. Yes.

Mr. MADIGAN. And that was the late at night occasion?

Mr. VOLCKER. That is correct.

Mr. MADIGAN. Thank you.

Mr. Chairman, my time has expired.

Mr. JONES of Tennessee. Thank you very much, Mr. Madigan. Now I yield 5 minutes to Mr. Hance.

Mr. HANCE. My first question or statement would be to Mr. Stone. After you were first appointed, I visited with you about the number of small investors I have in my area who deal with feedlot operations that they will go to the banker and they agree he will loan them money for 150 head of cattle, and the bankers always like for them to hedge those cattle. I was somewhat disappointed and shocked that in your statement it seemed like you were coming out against the small and little people in this country. I was glad at least you are not against the small hedger.

You are against the small speculator maybe, but I think one thing that you have got to look at if you put rules on the small speculator, the end result is going to be that you are going to affect the small hedger.

I am really not worried about the Hunts or someone like that making a margin requirement. It seems like the more people you have to participate, which I think we agree upon, the more people that participate, the better off you are, and if you get into a position of hurting these people that are out there feeding 150 head of cattle or 300 head of cattle every 6 months, I think it hurts the overall market, so I would hope in any decision or any vote that you have you and the other Commissioners would take those people into consideration because I think they are very important.

One other thing that I would like to ask: Do you all have any indications on the exact percentage, and one of you may have touched on it before I got here, of the silver market that the Hunts controlled?

Mr. STONE. There are various ways of looking at that. The percentage of the open interest controlled by the Hunts was discussed in Commissioner Dunn's statement. It was at times over 10 percentage points.

Another way to look at it, that I think is perhaps more useful, is that the Silver Users Association noted at one point that their position of over 150 million ounces in long positions in futures represented some 97 percent of the domestic commercial use of silver.

Mr. HANCE. But on the market in the futures you said in the tens or in the twenties of the percentage. I would like for each of the Commissioners to think about this and maybe write me a letter on it.

What would be the possibility of your support or disapproval, either way, of legislation that would say fix a percentage of 10 percent that anyone could hold on any one commodity, say cattle, silver or whatever, but do away with all limits. Do away with all limits that you presently have in the grains and cattle at the present time.

Mr. STONE. We can comment on that later for you in writing. We will be discussing similar subjects in Commission meetings in the near future. We have discussed limitations in the past that might be on a percentage basis. We did that at a very recent meeting of the Commission and we will get back to you if you would like in writing on that subject.

Mr. HANCE. It seems to me you would encourage more trading if you did away with the limits, and put a top percentage on it, and it is highly, highly unusual I am sure that anyone on any commodity ever gets above 10 percent. I mean it is just unheard of, and I don't know that anybody would be in that individual position.

Mr. STONE. It is more likely in the delivery month than it would be early, but it is certainly correct that 10 percent is a very high number, and that the 20 percent figure we saw in the case of the Hunts is extremely rare.

Mr. HANCE. Thank you very much. I yield back the balance of my time.

Mr. JONES of Tennessee. Thank you very much, Mr. Hance. And now 5 minutes to Mr. Richmond.

Mr. RICHMOND. Thank you, Mr. Chairman.

Mr. Volcker and Mr. Stone, perhaps you can answer my question together. I am interested in the whole area of conflict of interest.

I know the Hunts have or have had major interests in brokerage firms, Bache and others. Under whose jurisdiction would that be? Would that be the Fed's or the CFTC?

Mr. VOLCKER. I think, in that case, the SEC's.

Mr. RICHMOND. SEC?

Mr. VOLCKER. Yes. It is certainly not under our jurisdiction.

Mr. RICHMOND. And the CFTC has no jurisdiction?

Mr. STONE. Stock ownership in broker dealers would be the SEC's concern more than ours.

Mr. RICHMOND. Do you think it is healthy for a group of speculators, speculating to the extent the Hunts did, to also hold major interests in trading firms?

Mr. STONE. My personal view is that there are conflict of interest problems necessarily raised, and that when we looked at the loans that occurred, granted by Bache to the Hunts, those had to intensify the concern of possible conflict of interest.

Mr. RICHMOND. Commissioner, how do you feel about it?

Mr. POLLACK. We are now inquiring into it. I think it will depend on what the facts establish. I don't think that the mere ownership alone necessarily indicates that there is anything bad.

Mr. RICHMOND. Do you think someone should be allowed to own a major piece of a brokerage firm and also be allowed to speculate to the extent the Hunts did? Do you see anything wrong at all in this?

In other words, you don't think that the situation I described represents a disadvantage for other investors, speculators, hedgers, and what-have-you, who also work in the same exchanges?

Mr. POLLACK. It depends on what the facts show, and it would depend on what your term speculation means.

I didn't mean to suggest that there might not be anything wrong. What I am trying to say is, until we determine what the facts are with respect to their trading, and how that intertwined with their ownership in the particular broker/dealer, I am unable to answer your question definitely. We do have regulations that require disclosure of business done with any public corporation.

Mr. RICHMOND. Commissioner, what about a disclosure as to the size of the interest the Hunt family has in Bache, for example? Has that been disclosed?

Mr. POLLACK. Well, that is a question that we are looking into. If they owned either separately or as a group more than 5 percent of the stock interest of Bache, they were required under the law to report that ownership together with additional information that is required by the schedule that we have.

Mr. RICHMOND. Did they report it under the law, because I have read—

Mr. POLLACK. They did not file any statement, as would be required if they owned either individually or acting as a group more than 5 percent of the stock of Bache.

Mr. RICHMOND. What about the whole area of a trading firm, like Bache, financing customers, as you know they frequently do. Would that not give an outfit like the Hunts, with its feet in both speculation and investment, an unfair advantage?

Mr. POLLACK. The financing end would be covered by the margin regulations. If they complied with the margin regulations that are applicable to anybody or any customer who was doing business with that firm, they would be in accordance with the law and regulations.

If they didn't, then there would be a problem with respect to that. At the present time, as I indicated in my opening statement, we are making an intense inquiry into all of these aspects to determine just what did occur insofar as the relationships between the Hunts and Bache were, and after we get that we will be able to determine whether there were violations of the previous provision I mentioned, or other provisions of the securities laws, or whether indeed there ought to be additional regulations to protect the securities aspect of the broker/dealer business from commodity or other trading. That is a matter we are also looking into.

Mr. RICHMOND. One last question.

Mr. Stone, how do you feel about traders having personal interests in brokerage firms or other personal interests which would not put them on a par with the average investor?

Mr. STONE. The issue of favoritism of one customer over another is a very serious issue, and any evidence that favoritism was occurring or was likely to occur would be of great concern.

Mr. RICHMOND. I am talking about the fact that we do have traders in all of the exchanges who may or may not have stock interests in brokerage firms.

Mr. STONE. It is very difficult to eliminate all conflict of interest from the private sector.

Mr. RICHMOND. I would like to know if we are taking some steps to eliminate these areas of conflict of interest, and if so, what steps are being taken?

Mr. STONE. I don't think any steps are being taken that would forbid a trader from owning part of a brokerage firm.

Mr. RICHMOND. Don't you think that is something we should consider?

The trader obviously has an advantage over his customers, doesn't he?

Mr. STONE. To the extent that there is any advantageous treatment or threat of advantageous treatment, it is certainly worth discussing.

Mr. RICHMOND. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Richmond. I yield 5 minutes to Mr. Coleman.

Mr. COLEMAN. Thank you, Mr. Chairman. I am going to quote from Mr. Dunn's statement on page 7 and he says:

It is the view of the Commission therefore that no statutory changes need to be acted upon by this subcommittee at this time. The Commission believes that all future markets should continue to be regulated under the general authority and direction of the CFTC.

Mr. Martin, do you agree with that statement?

Mr. MARTIN. Yes, I do.

Mr. COLEMAN. Mr. Gartner, do you agree with it?

Mr. GARTNER. I agree.

Mr. COLEMAN. Mr. Stone, do you agree with that statement?

Mr. STONE. Not completely. That is, I have not argued that jurisdiction ought to be transferred to another agency, but I have argued that additional statutory authority in particular with respect to margins would be valuable.

Mr. COLEMAN. Thank you.

Mr. Stone, you earlier indicated a concern in your statement about the ramifications of the silver market. For example, silver-smiths being thrown out of jobs, jewelers somehow going under and so forth.

I assume you have that same concern about the American farmer?

Mr. STONE. Yes.

Mr. COLEMAN. That is a laudable concern, but I wonder can you cite me any authority under the law that you operate under that requires you or even allows you to be more than just concerned as a private citizen? Isn't that our job?

Mr. STONE. There is very little that the CFTC can do about employment, if anything.

My reason for saying it was that I don't want to see the futures markets used in such a way as to make greater the likelihood of a general economic problem.

Mr. COLEMAN. Then I assume that you have had your staff working on this problem in the future. In fact, I cite the report which is a rather nice thick report here, a report of the Commodity Futures Trading Commission on recent developments in the silver market, in which you state that your staff has been monitoring the silver market closely since 1976. The report further says that they were surprised, and it was not anticipated about the collapse on March 26 and 27.

How do you square those two statements, and if you are so concerned, why weren't you pushing a little harder?

Mr. STONE. My view of what happened in the silver market late last year and early this year is that a speculative bubble was formed, and once a speculative bubble has formed, it is very difficult for anyone, if not impossible, to predict when it will burst and how.

The best thing would be if the air came out of it slowly and without a sudden change in price. During the period from mid-January through February, we certainly hoped that that would be the case. As it turned out, toward the end of March there was a sudden collapse, but I don't think we or anyone else anticipated when that would occur or whether there would be a sudden collapse.

Mr. COLEMAN. So it is never possible?

Mr. STONE. Once a bubble is formed, I think it is impossible to predict how and when it will break.

Mr. COLEMAN. So you wouldn't be asking for any new authority to look into crystal balls on that aspect?

Mr. STONE. The important thing to do is to consider preventive medicine to prevent these bubbles from forming in the future. Once they have formed, there is no good answer.

Mr. COLEMAN. Let me ask Mr. Carswell from Treasury. Treasury from time to time auctions gold. I don't think that there is any auction of any silver in this period of time. Why?

Mr. CARSWELL. Treasury doesn't have any silver to auction.

Mr. COLEMAN. That is it? All right.

Mr. CARSWELL. We transferred the silver to the GSA in 1970. They have a lot of silver.

Mr. COLEMAN. Were they auctioning it off during this period of time?

Mr. CARSWELL. They were not.

Mr. COLEMAN. Do you ever advise the GSA as to what to do with their silver?

Mr. CARSWELL. No, we have never been asked. They handle it the way they handle any other commodity.

Mr. COLEMAN. Should we look behind the USDA for a whole pile of it out there?

Let me ask Mr. Volcker, is it or is it not patriotic to use credit cards?

Mr. VOLCKER. I don't think it is a matter of patriotism.

Mr. COLEMAN. Mr. Volcker, I hate to use the word "speculated," but it was understood that perhaps the Hunts were going to use

some sort of certificates, backed by and guaranteed by the physical silver that was involved and in their possession.

I suppose this could be done with wheat and corn. We could have, shall we say wheat checks or something like that?

Could you tell me what the Federal Reserve's position on this is and is this legal under current law?

Mr. VOLCKER. I think the Hunts were going to do that abroad. I don't know, offhand, that it would be illegal, assuming they followed all the registration procedures and disclosure procedures of the SEC. I don't know of any prohibition on that kind of thing offhand.

Mr. COLEMAN. Do you think there should be?

Mr. VOLCKER. No, I wouldn't like to see it. I think this is a reflection of a kind of speculative atmosphere. I would not like to see that kind of thing.

I presume that the Hunts' explorations in that direction were a rather desperate effort to finance their silver position.

Mr. JONES of Tennessee. Thank you, Mr. Coleman.

Mr. Hopkins.

Mr. HOPKINS. Thank you, Mr. Chairman.

Let me thank these gentlemen for attending this morning. In my opinion we have an overabundance of regulations in this country by the Government. As a matter of fact, I have come to the inescapable conclusion that the Government is doing such a good job that the people can hardly stand it.

In reference to that, Mr. Stone, in a recent testimony before the Congress, you testified that the CFTC needed no more authority. Just a few months later you are asking for more authority. Are things so much different today, or are you just looking for a scapegoat?

Mr. STONE. I hope we will learn something from the events of last March. I didn't know, for example, at the time of our last oversight hearing, how closely intertwined the financial affairs of the Hunts were with those of their banks and brokers. My views have changed somewhat.

I also feel that the time of our last oversight hearing, that is in the midst of what was still a very delicate situation, was not the right time to be discussing long-term solutions to problems. It is best to discuss those in a reasoned environment after the immediate problem is over.

Mr. HOPKINS. Mr. Volcker, you say that neither yourself nor the Federal Reserve initiated any effort to obtain bank loans in connection with the financial transactions of the Hunt brothers, is that correct?

Mr. VOLCKER. Correct.

Mr. HOPKINS. Is it not true you originated the emergency meeting of the banking association which allowed the Hunt brothers a forum to plead their case for a bail-out loan?

Mr. VOLCKER. No, I had nothing to do with that meeting.

Mr. HOPKINS. Mr. Stone, based on the Commission data, it appears to me that if there was excessive speculation in silver, it was in the cash market, not the futures market.

Nonetheless, your recommendations relate to the futures market. Shouldn't you really be recommending that the Federal Govern-

ment regulate or prohibit people from buying silver and someone like you be charged with fixing the cash price?

Mr. STONE. CFTC is not a price-setting agency, nor can it ever be.

The problem did occur in the cash market as well as the futures market, but to minimize the role of the futures market would be a mistake. The figure that I quoted earlier of long positions of 155 million ounces, representing some 97 percent of the annual domestic use of silver was a futures market statistic. That is a very dramatic figure.

Mr. HOPKINS. From your recommendations regarding margin authority it appears to me that CFTC could have done a better job of setting margins during the rise in the silver market. Yet, if I understand the data presented by the CFTC, the exchanges set very high margins, even higher than was required by cash silver.

What do you think should have been done with respect to the margins?

Mr. STONE. I don't criticize the actions of the exchanges once the problem was identified. The sort of authority I have suggested ought to be on the books is authority that would be used well in advance of any developing problem.

The sort of authority I am talking about would allow the government to set a floor on margins, so that there would never in this case have existed the very high speculative volumes that existed for several years before the problem developed.

Mr. HOPKINS. Mr. Chairman, that is all the questions I have. I yield back the balance of my time.

Mr. JONES of Tennessee. Thank you, Mr. Hopkins.

Mr. ENGLISH, I apologize to you for taking Mr. Hopkins out of order, and without objection, because of that, I will give you a couple extra minutes.

Mr. ENGLISH. Thank you, Mr. Chairman. I am always happy, in an election year, to provide the opposition with every opportunity. I think they are going to need it this year.

Mr. Stone, I noticed that in your written statement here you get into the fact that the perspective is basically your own and there seems to be some disagreement among the Commission as to exactly what happened and why it happened and so on. Could you enlighten us, for the record, on the experience you have with the futures market?

Mr. STONE. If you are asking for a statement of my background, that is on the record in the testimony at my confirmation hearings. Specifically with respect to direct participation in the futures market, I have never bought or sold a futures contract, nor had I been on the floor of a futures exchange prior to holding this job.

My interest and background in the futures market was as an academic rather than as a participant.

Mr. ENGLISH. And how long have you been in the job that you are now holding?

Mr. STONE. I took office last May.

Mr. ENGLISH. So we are talking 12 months; that is, as far as your active involvement in the futures market, it is about 12 months' worth.

Mr. STONE. Other than by reading and studying, that is correct.

Mr. ENGLISH. On page 3 of your written testimony I notice that you are stating at the top of the page, "The most commonly examined threat from the silver collapse has been the danger to financial institutions during the last week of March."

Could you enlighten us somewhat as to who those financial institutions were?

Mr. STONE. Bache has made public the fact it was concerned about its own financial condition. I am somewhat hesitant to mention names of institutions which have not chosen to make that information public themselves. I would not want to say anything which would hurt their financial condition.

Mr. ENGLISH. Well, were there banks? What kind of institutions?

Mr. STONE. There was concern about the brokerage firms that had loaned money to the Hunts more than about any other types of institutions, but some of the loans were made on a back-to-back basis. The Hunts had been loaned money by brokers who in turn had borrowed money from banks.

Mr. ENGLISH. What I am talking about is more on numbers, not what they did and the type of institutions. How many brokerage firms are you talking about?

Mr. STONE. There were three brokerage firms that we were particularly concerned about.

Mr. ENGLISH. Three brokerage firms. Do you have any banks?

Mr. STONE. It would be better to ask the bank regulators that question. I am not expert in bank financial conditions.

Mr. ENGLISH. You are talking about the silver collapse being a danger to the financial institutions during the last week of March. You must have had some knowledge when you put the statement together there were more than three brokerage firms in trouble.

Mr. STONE. I don't think my role primarily focused on danger to banks. I am suggesting I probably am not the right witness at this table to ask about banks.

Mr. ENGLISH. We will get to the other witness. The point I am trying to make is do you know of any banks that were in trouble?

Mr. STONE. I do not think it is responsible for someone to discuss banks that might be in trouble. It is dangerous for the solvency of a bank to have rumors about its financial condition.

Mr. ENGLISH. I am asking if you knew of any banks in trouble, not the name. The point we are making is that you come up to this committee as an expert witness. You are the Chairman of the Commission. You have made decisions that have impacted on this industry. You have made decisions in behalf of the U.S. Government and the people of this country, and now you are trying to tell me that you don't want to even tell us what types of institutions figured into this decision?

Mr. STONE. I have told you what types of institutions: The brokerage firms and the banks that loaned the money.

There is a list in our report of banks that were involved in some of the loans. That has been made public.

Mr. ENGLISH. The point is you are talking about the danger to financial institutions. That is a pretty broad-reaching and devastating type of statement to make, I would think.

On down in here, we are talking about that the Chairman of the Federal Reserve and the Deputy Secretary of the Treasury, and the

Chairman of the Securities and Exchange Commission and yourself, for 3 days monitored the potential for disastrous ripple affects.

What all did this monitoring consist of? How did you do that?

Mr. STONE. Each of our staffs were supplying us information they were collecting from the private sector participants in the silver markets and the related institutions.

Mr. ENGLISH. Anything else?

Mr. STONE. That was the principal source of information.

Mr. ENGLISH. So that was it.

Mr. MADIGAN. Would the gentleman yield on that point?

Mr. ENGLISH. I am afraid I am going to run short of time. I will at the end of my time, if that is OK. I have just a couple more points.

At the bottom of page 3, the second paragraph down, you have the statement "A professor of economics who wrote as follows in describing the situation;" and then he gets into "The crash of the silver market revealed that funds are available for large deals that violate basic canons of finance . . ." and so on and so forth. Could you identify for us who this professor of economics was?

Mr. STONE. Yes, sir, that was from an article I read in the Journal of Commerce, written by Hyman Minsky at Washington University in St. Louis.

Mr. ENGLISH. On down in that statement, after the quotation you make the point you agree and said, "We will never know how close we came to the edge of general financial panic."

Mr. STONE. Yes, sir.

Mr. ENGLISH. How close do you feel we came?

Mr. STONE. I am among those who will never know.

Mr. ENGLISH. You are supposed to be the authority. You are one of these guys who is supposed to know. You are supposed to have some idea. What are we paying you for?

Mr. STONE. I don't claim to be omniscient and I don't think anyone would be in a position to answer that question.

There was substantial concern, as evidenced by the fact that officials at the level mentioned in my testimony were devoting full time to this situation. I was not the only one concerned by any means.

Mr. ENGLISH. Reading on through pages 4 through 7, the general thrust, I think, of what you are saying there, at least the impression it leaves, although you don't state it and I want to give you a chance to say whether the impression is correct or not, it implies that the futures market primarily was at fault for what developed in this matter.

Is that the impression you want to leave, that there is weakness within the futures system and that brought all of this about?

Mr. STONE. More precisely I would say the futures market played some role in what developed. There is no question that Commissioner Dunn is correct in his assertion that the cash markets both in the United States and around the world had a very substantial role in what happened.

Mr. ENGLISH. You are saying the futures market itself caused this, not the fact that the futures market was reflecting what was taking place elsewhere?

Mr. STONE. I said the futures market played some role in it. By providing a low downpayment vehicle for the acquisition of massive amounts of physical silver, it made it easier to take these large cash market positions.

Mr. ENGLISH. Quickly, I would like to ask you a question, Mr. Volcker. There was a rumor circulated, which I have heard, and today they are talking in the Post that you were instrumental in working out an \$800 million line of credit to the Hunts. It does not say in the article where that money came from. Can you tell us who made this loan or made available the line of credit?

Mr. VOLCKER. The loan has not been made yet.

Mr. ENGLISH. Who is it going to be made from?

Mr. VOLCKER. There is a syndicate, a consortium of banks; I don't remember the exact number, and I don't remember the precise participants, but 10 or 15 banks.

Mr. ENGLISH. Can you tell us, were there banks in trouble as Mr. Stone says? Was there danger to financial institutions and were banks included in those?

Mr. VOLCKER. The first line of jeopardy, so to speak, was clearly brokerage or commodity firms—some of which were extremely sizable brokerage firms, including the second largest in the country—and have many interconnections in other markets.

There were, directly or indirectly, perhaps a billion dollars of bank loans involved through brokerage houses, or direct lending to the Hunts, or otherwise. That is a sizable amount of bank loans.

Mr. ENGLISH. There were banks in danger?

Mr. VOLCKER. I would not say any individual bank was in danger, in the sense your question suggests, but I think there was a potential for a very considerable financial disturbance at a time when markets were extremely tight and concerned because of other factors.

Mr. ENGLISH. Thank you, Mr. Chairman. You have been very kind.

Mr. JONES of Tennessee. Thank you very much, Mr. English. Your time has expired. Mr. Baldus has returned.

Mr. BALDUS. I yield.

Mr. JONES of Tennessee. Mr. Baldus yields to Mr. Daschle.

Mr. Daschle, you are recognized for 5 minutes.

Mr. DASCHLE. I would like to ask what special incentive you gave the bank to make the loans, what special arrangements were made? This is an unusual size and position for these banks to be in and I would like you to further explain that if you could.

Mr. VOLCKER. I gave them no special incentive. If I gave them anything I gave them disincentive in the sense that my concern was primarily that this loan be structured in such a way that to the best of our ability and their ability it could not release any funds for renewed speculation in silver, other commodities markets, the securities markets, or elsewhere.

Mr. DASCHLE. Was there any kind of guarantee put to the banks in behalf of the Hunts?

Mr. VOLCKER. The Hunts, in the end, are at risk on the loan. The loan is directly to Placid Oil, which is primarily an oil and gas producing company, in trust, and the Hunts are the beneficiaries of that trust.

Mr. DASCHLE. In no way did you provide any additional support for the Hunts' position in acquiring the loans?

Mr. VOLCKER. No, my concern was that the provisions of the loan and the covenants of the loan prevent speculative activity. The inquiry from the banks was basically to let me be aware of this.

Mr. DASCHLE. Did you act as intermediary?

Mr. VOLCKER. Between who?

Mr. DASCHLE. Between the banks and the Hunts?

Mr. VOLCKER. By no means.

Mr. DASCHLE. Did anybody within the Fed do that?

Mr. VOLCKER. No.

Mr. DASCHLE. You were only provided information?

Mr. VOLCKER. We were provided information and indicated our concern about any possible speculative concerns. Their inquiry was partly in the nature of, "How does this fit under the loan restraint program?" Certainly the answer to that was there are no exemptions. And as to whether we would consider it speculative in the sense of being inside or outside our strictures about speculative loans, our response was, "If you structure this thing so it can't give rise to additional speculation, we would not criticize the loan as being a speculative loan."

Mr. DASCHLE. I would like to pursue that with one other question. Have there been similar situations in recent history where we have provided this size of loan under these circumstances—

Mr. VOLCKER. The banks?

Mr. DASCHLE. The banks, I should say. Can you provide me with a couple precedents?

Mr. VOLCKER. I cannot.

Mr. DASCHLE. This is unprecedented?

Mr. VOLCKER. I don't know of any precedents for a loan of this size for this kind of purpose.

Let me point out that this particular credit to which you were referring is a restructuring of loans that already exist, or a restructuring of credits of various sizes and types that already exist.

Mr. DASCHLE. Can you generally describe the terms under which the loans were made?

Mr. VOLCKER. In general terms, the loan is to Placid Oil and—

Mr. DASCHLE. How many banks?

Mr. VOLCKER. My memory is 10 to 15 banks.

Mr. DASCHLE. All under the same terms?

Mr. VOLCKER. Yes, it would be all under one loan agreement. The loan is not completed, as I indicated.

It sets up, as I understand, a partnership arrangement between the Hunts and Placid, where Placid is the general partner and the assets of the Hunt silver, other securities and other commodities, they all pour into the partnership, so silver will be liquidated over time. And, during the period the loan is outstanding there can't be acquisition of the silver or other commodities or securities.

The loan is well defined to prevent speculative activity by the parties at interest while the loan is outstanding.

Mr. DASCHLE. My time is nearly out but I want to ask Mr. Stone if he could address this because I think this is the purpose of our hearing this morning.

Mr. Dunn states, and I am quoting from the testimony:

Margins cannot control much capital flow. Certainly, raising commodity margins cannot be expected to redirect the flow of capital into the equity market if the securities markets do not appear to be attractive.

I would like to have your reaction to that statement.

Mr. STONE. Thank you very much, sir. I feel that the redirection of capital flows to the securities markets would not be the principal reason why higher margins would be a good idea. My concern is principally about excessive speculation in commodities markets. I think that it is generally agreed that higher margins would affect the amount of speculative participation in commodities markets.

Mr. DASCHLE. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Daschle. Mr. Fithian is not a member of the committee so I am going to hold him until last, but I will give him the opportunity, however.

At this time the Chair recognizes Mr. Baldus for 5 minutes.

Mr. BALDUS. Thank you, Mr. Chairman.

Mr. Volcker, do you have any knowledge of the commodities industry or is anyone on your staff knowledgeable enough about the industry to set margin requirements?

Mr. VOLCKER. "Knowledgeable enough" is the question. If we were to set margin requirements on commodities, we would undoubtedly bolster our staff. We have some very capable people there now, but if we were going to get into this in detail we would have to have a larger staff, no question about it.

Mr. BALDUS. What would be your estimate of additional staff?

Mr. VOLCKER. I could not estimate at this point.

Mr. BALDUS. In view of the dynamics of the futures market, should the Fed be responsive in setting or changing market requirements?

Mr. VOLCKER. I have considerable respect for the capabilities and expertise that could be developed in the Federal Reserve System.

Mr. BALDUS. That is an answer, but not much of one.

Mr. VOLCKER. You know, I am tempted to say nobody is perfect in all circumstances, but we have had a certain amount of experience in margin requirements—in the stock market, for instance.

I don't want to prejudge the question as to whether we should indeed get into this area, but it is an area which we will be looking at very closely.

Mr. BALDUS. How long does the Fed ordinarily take to propose and adopt amendments to its margin requirements, and can you give us any examples of how long it has taken in other areas such as the adoption of margin requirements for exchange traded stock options?

Mr. VOLCKER. I can't give you any general estimate. I don't know how one measures how long it takes to get out a regulation from a gleam in a staff member's eye to a final regulation.

Mr. BALDUS. Could you just give some ball park estimation?

Mr. VOLCKER. If a regulation just changes the margin requirements, we do it quite quickly. That need has not arisen for quite awhile; there hasn't been any particular problem in the stock area.

Mr. BALDUS. You can do it with a meeting?

Mr. VOLCKER. If we saw some reason to change margin requirements in stocks we could do it very promptly.

Mr. BALDUS. By deciding?

Mr. VOLCKER. Yes, that is an easy change; it is not a complicated regulation; you change the percentage number. It is easy to implement, but it may be a difficult decision.

Mr. BALDUS. The effect might be very useful from time to time?

Mr. VOLCKER. It has been thought to be, in the past. Actually we have a major study underway on our whole approach toward margin requirements on stock; this has been a very elaborate study and review of our whole experience with margin requirements on stock.

Mr. BALDUS. You assume as you move the marketing requirements up trade speculation will diminish some; correct?

Mr. VOLCKER. You assume some speculative activity may diminish. There is no terribly clear correlation between moving margin requirements and stock prices, I might say.

Mr. BALDUS. What is the purpose of the study?

Mr. VOLCKER. To examine some of these relationships. There, basically, are two purposes. First, can we make the regulation simpler yet as effective as it needs to be, for the reason that it is desirable to make regulations as simple as possible.

Second, our purpose is also to examine some of the basic relationships between margin requirements, stock prices, speculative activity, and the rest. We have examined what evidence and literature is available on that subject.

Mr. BALDUS. Do you know if there is a difference between margin for stocks and margin for commodities, and if you do, what are the differences?

Mr. VOLCKER. The major difference is that the margin for stock applied to the purchase of stock governs the amount of money that can be borrowed to purchase that stock. When you are operating in the futures markets—as opposed to the spot market—in commodities, you are governing what is, in effect, a kind of good-faith arrangement that provides a kind of bond performance in case the price of futures fluctuates; you don't have to put the cash up at the moment. There is not a lot of credit, and that is the distinction I think Chairman Stone has made. Futures are rather a cheap way to speculate, because you don't have to put up cash except to the extent of the margin requirement.

I might say, I don't agree with the distinction that perhaps some were trying to draw between the cash market and the futures market. It is all one market, in a sense. The futures market happens to provide a vehicle where the potential exists for speculating without any cash, or with very small amounts of cash, and that does not exist in the cash market, but they are very much related markets.

Mr. BALDUS. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Baldus.

Now the Chair has yielded time to each member of the subcommittee, and we have Mr. Fithian, a member of the full committee who is here, and very interested. Mr. Fithian, we yield you 5 minutes.

Mr. FITHIAN. Thank you very much, Mr. Chairman. I appreciate the consideration.

I wanted to pursue a couple more lines of questioning on the loans to the Hunt brothers, Mr. Volcker. The media reported that the Fed approved the loans; is that correct?

Mr. VOLCKER. Approved isn't the word I would use. The inquiry was about the loan restraint program and how this fit in, either under the general guidelines or the speculative guidelines.

Mr. FITHIAN. Could you have discouraged, could you have negated, could you have defeated the loan if you chose?

Mr. VOLCKER. We could have said, "Whatever you say and however the loan is structured, we consider this loan speculative and will criticize it." That could have been the response, given the nature of the inquiry. The response, basically, was that if they structured the loan carefully to avoid any resumption of speculative activity, we would not object to the loan on the ground of it being speculative. Please understand we have no legal authority here.

Mr. FITHIAN. I understand the legal authority, but had you objected to the loan on the grounds that it was somehow assisting speculation, would the loan then have been made, or would it not have been made?

Mr. VOLCKER. I can't answer the question definitively. That would have been something the banks would take into consideration; I presume they wouldn't have made the loan then, but I don't know.

Mr. FITHIAN. Without the law, isn't that really the way the banks operate, if the Fed discourages something they get out of it quickly?

Mr. VOLCKER. I wish it were that simple.

Mr. FITHIAN. That is what the banks tell us.

Mr. VOLCKER. They may say that to you. They don't always say that to me. I presume they would ask and listen if I had discouraged them, but under all the circumstances, I did not enter an objection.

I have a great interest in making sure that the loan is properly structured in an antispeculative sense.

Mr. FITHIAN. Let me say as a layman in this field that I appreciate the efforts you made to try to assure that the loan was not speculative, but let me also tell you, because I would be less than candid if I didn't that there are a great many people in this country who feel something is wrong when they can't get mortgage money for houses and the rest and the Hunt brothers can get an \$800 million loan for speculation.

Mr. VOLCKER. I understand that.

Mr. FITHIAN. If I may finish, I think it is justifiable. I don't think the Fed did its job in this case. I think you did not do your job in this case.

Mr. VOLCKER. Let me say I understand the concerns. But I don't know what you mean by our job. The problem that arose and the problem that disturbs me and you, and everybody else is that this whole episode gave rise to a very substantial amount of bank credit before we knew anything about it.

Mr. FITHIAN. Perhaps it would help your perspective of where I am coming from, as I said why. The Hunt brothers have testified before the Senate that they don't know whether they lost or made

money. Mr. Stone testified this morning a lot people did lose money and there are lots of other things wrong with this kind of speculative bubble however we regulate it or don't regulate it.

It seems to me that given that perspective and given the tremendous support we have in this country for the ideal of let free enterprise be free, that perhaps one should, if one speculates wildly in the market, be willing to suffer the consequences of such speculation, and by the nondiscouragement of the loan, it seems to me that we have by Government action, if you will, or inaction, shielded these speculators from their just desserts.

Let me turn to the purpose of the hearings. I just wanted to advise you of that.

Mr. VOLCKER. I just don't want the record to show that I agree with that. I agree that they ought to "suffer the just desserts"—or however you want to phrase it—and I don't know how much they are going to suffer or not suffer in the end. They are still at risk in the silver market. The question we had here, in part, was how many innocent people would suffer along with them.

Mr. FITHIAN. Thank you. I want to ask one question and I expect the answer will run over my time, but I think it is critical to my understanding of this.

As I understood the overall testimony this morning as to what our Agriculture Committee should do, Mr. Carswell from Treasury—tell me whether I am wrong or not—essentially said that we should defer or delay legislative action until the reports are in and you are ready to make a recommendation.

Mr. Volcker from the Fed essentially echoed that sentiment, unless I misread him, and the Securities and Exchange Commission—Mr. Pollack, from the SEC, is on the same wavelength, and I believe I understood Mr. Dunn and two of the Commissioners to be in that direction but Mr. Stone is advocating that we move on allowing or mandating increased margins.

Now, before I have to act on this, if we do in the full committee, is that a correct assumption of where everybody is or did I misquote somebody?

Mr. POLLACK. I am not sure whether the SEC is correctly quoted. We would agree that some form of margin regulation is necessary, and we have great confidence in the Federal Reserve Board's ability, based on the experience we have had with margin setting in securities, for them to have that authority so that it can be used to prevent, as Chairman Stone has described it, the bubble from bursting because we don't look forward to having a repetition of what occurred in the silver market again.

Mr. FITHIAN. So then I did have you misquoted. You would prefer that we go ahead and act now and give the Fed that authority?

Mr. POLLACK. Yes; I think that the importance of having the authority that is it could be used. Mr. Volcker has indicated that some expertise would have to be built up, but I think it is not consistent with good market regulation or with market efficiency to permit in the first instance, a bubble to develop, as it might on the top of a nuclear plant. By that time, you have lost your control over it.

The essential part of regulation should be to have these disciplines in effect, so that they prevent the bubbles from forming, rather than waiting for a bubble to burst and hope that it doesn't take down the whole economy with it.

Mr. FITHIAN. Thank you, Mr. Chairman. I would just presume the same advice from these folks.

Mr. JONES of Tennessee. Thank you, Mr. Fithian, and if you did not get a complete answer, you can submit it in writing.

I am going to ask that you gentlemen, the members of the subcommittee who have questions unanswered, and I have some also, that we agree to submit them in writing to the individuals we want answers from, so, without objection we will do that. Then I have some documents that I would like to ask unanimous consent to make a part of the record, two letters from the Commodity Futures Trading Commission to Mr. Foley, the chairman of our committee, and then the CFTC's big report, and there will be others also.

[The Report of the Commodity Futures Trading Commission on "Recent Developments in the Silver Futures Markets" is held in subcommittee file. The letters to Mr. Foley follow:]

COMMODITY FUTURES TRADING COMMISSION

2033 K Street, N.W., Washington, D.C. 20581

James M. Stone
Chairman

May 16, 1980

Honorable Thomas S. Foley
Chairman
Committee on Agriculture
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

You have asked for comments on H.R. 7183, a bill extending the Commission's authority over margins in the trading of commodities. The Commission has responded by letter to you, conveying the majority position of opposition to the bill. I would like to set forth briefly my dissenting opinion.

On several occasions, I have expressed in public testimony the view that excessive speculation in commodities is not a harmless pastime but a danger to our national economic fabric. I have recommended that there be new restrictions on lending by financial institutions to support purely speculative activities in commodities, and I have urged that strict position limits be imposed to restrain large speculators from dominating vital commercial markets. In addition, I have urged that margin establishment authority be granted to an agency of government. Consistent with that view I would not wish to place myself in opposition to H.R. 7183. The bill, however, does not fully address the problems for which I find margin authority to be a useful response.

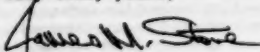
The arguments for commodity margin control are similar in some respects to those offered with respect to the stock market following the great crash of October, 1929. This is the case despite the fact that margins in the two areas are legally quite distinct. The distinctions should not be cited to obscure some important operational similarities between commodities and securities margins. One important commonality between these differing concepts of margin is that each serves as a threshold determinant for a customer considering entry to the market.

The binary decision on market entry and the quantitative decision on how large a position to take may in large measure depend on the relationship between available speculative cash and the amount of margin required. A second common element in securities and commodities margins is the potential role for margin in the acceleration of sudden market fluctuations. When margins deposits are low, price movements may generate sufficient calls for additional deposits that customer decisions about account maintenance are heavily influenced by ability to meet the calls. A market characterized by low margins is a market vulnerable to chain reaction price movements which may become self-sustaining and tend to distort fundamental price formation.

Congress has stated that excessive speculation can be a burden on valuable interstate commerce. It is thus appropriate to limit speculative activities to a level conducive to useful commerce. There is little dispute among experts in futures markets that control of margins is among the most powerful tools for influencing market participation. Margins, established at carefully selected levels in all markets at all times, can help to maintain a proper balance between speculation and hedging activity. The need to insulate markets from chain reaction price movements, moreover, is similarly met by an effective and ongoing program of minimum margin requirements. Margin authority granted only to cure a demonstrated irregularity, on the other hand, will not suffice for these purposes.

It is my belief that legislation giving the federal government the authority to establish minimum margin requirements would be very much in the public interest. H.R. 7183 may represent an improvement over current statute in that it grants margin authority broader than that implied by the Commodity Exchange Act. It does not, however, provide a sufficiently strong preventative power to deal with the issues I have referred to above before they become threats to the public. I hope these comments are useful to you and that further exploration of this subject can occur at hearings of the Committee on Agriculture scheduled for May 21.

Very truly yours,



James M. Stone
Chairman

cc: Honorable Dan Glickman

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

2033 K Street, N.W.
 Washington, D.C. 20581



May 16, 1980

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 MAY 19 1980
 U.S. DEPT. OF COMMERCE

Honorable Thomas S. Foley
 Chairman
 Committee on Agriculture
 Room 1301
 Longworth House Office Building
 Washington, D. C. 20515

Dear Mr. Chairman:

The Commission welcomes this opportunity to comment upon H.R. 7183, a bill to provide the Commission with standby authority to set margin requirements in the trading of commodities. The views set forth below reflect those of the majority of the Commission, Chairman Stone dissenting as to the Commission's position that there is no present need for legislation on the subject of margins.

As you know, in 1974 Congress specifically excluded the setting of levels of margin from the Commission's authority to approve or disapprove and to alter or supplement contract market rules. See Sections 5a(12) and 8a(7) of the Commodity Exchange Act, 7 U.S.C. 7a(12) and 12a(7), as amended, 92 Stat. 870-871 (1978). Thus, Congress has concluded that the authority to fix day-to-day margin levels should repose in the exchanges and their clearing organizations. The majority of the Commission continues to agree with that conclusion.

Further, as your Committee is aware, the Commission understands that Congress has already empowered the Commission to fix the level of margin in the case of market emergencies under Section 8a(9) of the Act, 7 U.S.C. Section 12a(9) (1976), which H.R. 7183 would redesignate as Section 8a(10). See Order of the Commission of November 3, 1976, raising to 100% the margin requirements in the November 1976 Maine potatoes futures contract traded on the New York Mercantile Exchange. See also Extend Commodity Exchange Act, Hearings Before the Subcommittee on Conservation and Credit of the Committee on Agriculture on H.R. 10285, 95th Cong., 2d Sess., at 23 (1978).

Accordingly, the apparent purpose of H.R. 7183 would be to provide the Commission with express margin setting authority in situations that do not rise to the level of a market emergency. The Commission also recognizes that this bill may have been precipitated by the developments in the silver futures markets between September 1979 and March 1980. Based on its present understanding of the situation in the silver markets during that period, the Commission does not believe that there is any need for further legislative authority to deal with similar situations. Of course, as our investigation of the developments in the silver futures markets progresses, it may be that we will decide that specific remedial legislation, such as that contemplated by H.R. 7183, is warranted. If such a decision is made, the Commission will, of course, submit any such legislative proposals for consideration by your Committee.

Should your Committee nevertheless feel that enactment of H.R. 7183 is warranted at this time, the Commission understands that the language of the bill would grant the Commission special and broad discretionary authority, such as that provided in existing Section 8a(9) of the Act, to assess relevant market factors and public interest considerations and to adjust margin levels both at the exchange and clearinghouse level without invoking the informal rulemaking provisions of the Administrative Procedure Act. While the provisions of the bill seem ideally suited for that purpose, the Commission wishes to comment on certain specific provisions of the bill.

Exchanges often set different margin requirements for the same contract based upon who is trading the contract. For example, exchange members trading for their own account may not have to post any margin. In addition, a different level of margin may be required with respect to hedgers than is required of speculators. The Commission understands that under the bill it would have the discretion to set a level of margin that would override any such exchange preferential exemptions or other classifications, such as those based on market participant, on particular delivery month or on any other factors.

In addition, the Commission assumes that the amount of deliverable supplies referred to in clause (A) of the bill would include consideration of the availability of deliverable supplies of the cash commodity which is the subject of a futures contract. The Commission also suggests that clause (C) be amended to make clear that the relative size of an individual trader's position refers to both positions in the futures and cash markets and would include all positions controlled by the trader. In this connection, the Commission understands that the broad authority conferred by the bill would permit the Commission to set margins at differing levels in the same contract based on the size of a trader's position in that contract.

Should H.R. 7183 be enacted, the Commission estimates that there will be no significant governmental costs to implement its provisions for the current and next five fiscal years.

The Commission, of course, stands ready to answer any additional questions you may have concerning H.R. 7183 or concerning the recent developments in the silver futures markets at the hearings to be held on May 21, 1980, by Chairman Jones' Subcommittee on Conservation and Credit. Those hearings should provide an appropriate forum for the Commission and members of the Subcommittee to engage in a useful dialogue on these issues.

Very truly yours,

Jane K. Stuckey
Jane K. Stuckey
Secretary of the Commission

cc: Honorable Dan Glickman
Honorable Ed Jones
Honorable Herman E. Talmadge
Honorable Donald W. Stewart
Robert Bor, Esq.
Carl Rose, Esq.

Mr. JONES of Tennessee. Mr. Madigan, did you have something?

Mr. MADIGAN. Mr. Chairman, I wonder if I could have unanimous consent of the committee to ask one more question of the CFTC representatives before they leave.

Mr. JONES of Tennessee. Without objection, Mr. Madigan will be given ample time to ask this question.

Mr. MADIGAN. Thank you, Mr. Chairman. Because there are other witnesses coming here, who are going to complain about the margin requirements having been increased on both the Chicago Board of Trade and the New York Commodity Exchange, and the effect of those increased margin requirements on their financial situation, I think it is important that the subcommittee try to establish who is responsible for those margin requirements being increased, and in that regard I would like to ask any one of the Commissioners who wants to respond whether or not the Commission encouraged the two exchanges to increase the margin requirements.

Mr. STONE. Congressman Madigan, I think I can answer for the Commission on that subject.

The Commission expressed a very profound level of concern about what was happening in the silver market at the end of the year last year. We did not at any time, however, tell either of the exchanges what the appropriate self-regulatory action to take would be, but we did urge that they take appropriate self-regulatory action.

Mr. MADIGAN. Thank you, Mr. Chairman.

Mr. GLICKMAN. Could I just ask the gentleman to yield on that question?

Mr. MADIGAN. Certainly.

Mr. GLICKMAN. The Hunts charged at the Rosenthal hearings that the CBOT and the other exchanges acted to preserve and protect the interests of member firms, and acted in a nonobjective manner. Have you looked into that situation, or do you intend to with respect to the margin requirements, further on to Mr. Madigan's question?

Mr. STONE. There is an ongoing review, both in our trading and markets division and in our enforcement division of anything that would constitute a violation of our act or regulations. I would therefore not want to comment on whether anyone took an inappropriate action on a self-motivated basis.

Mr. JONES of Tennessee. Thank you, Mr. Glickman. The committee will stand adjourned now until 1:30 p.m. Let me insist if the subcommittee members have questions to submit, please do so to the respective agencies.

[Whereupon, at 12:35 p.m., the subcommittee was recessed, to reconvene at 1:30 p.m., the same day.]

AFTERNOON SESSION

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will resume its sitting.

I would like to point out to the witnesses who are going to be here this afternoon that we do have some ground rules.

You may not have been here this morning, and I would like to say to you that we would like you to limit your testimony to 10

minutes. If you cannot finish it in 10 minutes and it takes a little bit more, we will accept, that but we hate to.

In case it's a long statement, if you want to summarize we will be glad to put the entire statement in the record, and then, to the members of the subcommittee, I think most of them will understand that we are using the 5-minute rule there. Each member of the subcommittee, when questioning takes place, will be permitted to use 5 minutes for questioning. In case we cannot make the second round of questioning, the questions not answered, as was the case this morning, will be submitted in writing.

Our first witness is Mr. John Clagett, president of the Futures Industry Association, Inc., Washington, D.C.

Welcome, John. I believe that you have a gentleman with you who is familiar to the group here. We will be glad to have you introduce Leighton Lang, vice president of the association.

I think, Mr. Clagett, this is Leighton's first appearance before this subcommittee; he was here all the time in an adjacent room working for Congressman Mathis, but I don't believe that he has been with the subcommittee.

Welcome, Leighton, we are glad to have you too.

Mr. LANG. Thank you.

STATEMENT OF JOHN W. CLAGETT, PRESIDENT, FUTURES INDUSTRY ASSOCIATION, INC., ACCOMPANIED BY LEIGHTON LANG, VICE PRESIDENT

Mr. CLAGETT. Thank you, Mr. Chairman.

It is a pleasure to have him with us, Mr. Chairman.

Mr. Chairman and members of the House Agriculture Subcommittee on Conservation and Credit, my name is John W. Clagett, president of the Futures Industry Association, Inc., Washington, D.C.

I am here as a representative of that association. Mr. Leighton Lang, vice president of the FIA, is with me. We are pleased to have this opportunity to appear before you.

The Futures Industry Association is a national association representing 66 commodity futures brokerage firms, both large and small, who are engaged in the business of dealing in commodity futures on behalf of customers. We estimate that our members handle over 80 percent of all customer business.

The Association also represents 73 associate members who are interested in various aspects of futures trading. They include major banks, accounting firms, law firms, 10 futures exchanges and others.

Without a precise knowledge of what occurred in the recent silver situation we cannot make a judgment as to what actually happened. Hopefully, after the various ongoing hearings and investigations are completed, we will know what occurred.

However, we cannot envision any scenario of what occurred which would call for additional legislation in the area of commodity futures trading. Insofar as futures trading is concerned, the Commodity Futures Trading Commission now has ample authority to take any action necessary to prevent a reoccurrence of the silver crisis.

The Commission has authority under section 6c of the Commodity Exchange Act to go into court to seek an injunction against any manipulator or cornerer.

If what occurred happened because one person or group of persons overextended itself and had too large a futures position, the Commission should have considered using its authority under section 4a of the act which authorizes it to set speculative limits.

Under section 4a, the Commission has wide discretion. It can set limits "across the board" for individual futures or, if the problem involves only the maturing future, set limits only in that future.

If the problem arose because a few brokerage firms may have accepted too great an exposure by carrying customers' positions that were too large in relation to the firms' capital, the Commission can correct the situation under its minimum financial requirements authority contained in section 4f(2) of the act, and require firms to have sufficient capital to safeguard against any risks inherent in carrying extremely large positions for a single customer or group of customers.

If none of the Commission's rulemaking authority which I have mentioned is sufficient to safeguard against future crises, then the Commission has broad authority under section 8a(5) of the act "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate or to accomplish any of the purposes of this Act; . . ."

There have been calls for new legislation. CFTC Chairman Stone, staunchly supported by SEC Chairman Williams, has called for Government control over commodity futures margins. Chairman Stone, in addition, has testified that he also needs broader authority in other areas.

These calls by Chairman Stone for additional legislation have not been supported by the other CFTC Commissioners. Chairman Williams has used hearings growing out of the silver situation to seek to expand his agency's "turf" at the expense of the CFTC and possibly the futures industry. None of these things has anything to do with what occurred in silver.

The imposition of higher margins or the control of margins by one or more Government agencies would have made no difference in the recent silver situation. Margins were raised regularly and to very high levels by the exchanges. Some individual brokerage houses raised margins faster and higher than did the exchanges. The result was that participation in the market dropped but prices continued upward and became more volatile. The market became extremely thin and lacked liquidity.

We are afraid that those who advocate Government controls over margins do not really understand what margins are all about. We would like to provide for the record copies of a paper prepared by Dr. Mark Powers, executive vice president of Thomson McKinnon Securities, which gives an excellent description of what is involved in futures margins and which Congressman Neal Smith inserted in the Congressional Record on May 14.

Dr. Powers is a well-known authority in commodity futures trading and in the field of agricultural economics. He has served as the chief economist of the Commodity Futures Trading Commission and the senior vice president of the Chicago Merchantile Exchange.

Dr. Powers does not believe the Government should even have standby authority over commodity futures margins, stating: "If a Government agency has standby authority, someone someday will find an excuse to use it."

In this connection, Dr. Allen Paul, the U.S. Department of Agriculture's expert on futures trading recently observed:

The essential purpose of margin deposits is to give integrity to the futures contract * * * Federal control of minimum margins requirements for futures trading in commodities has been proposed from time to time as another means of restricting credit in inflationary times.

Such an attempted use would be self-defeating, working against the best interests of producers and consumers alike.

In closing, we also note that in 1943, 1950, 1951, 1966, 1967, and 1973 Congress held hearings on bills which, in part, would have given the Federal Government authority to set commodity margins. None of these bills were passed.

We hope that this committee will conclude that the commodity futures exchanges should continue to set margins and that the CFTC and only the CFTC regulate the futures industry.

Thank you for your attention and consideration. I will be pleased to answer any questions you may have.

[The attachment to the statement is held in the subcommittee file.]

Mr. JONES of Tennessee. Thank you very much, Mr. Clagett, for your statement. We hope you can wait until we have heard all the witnesses and then we will call you back.

Our next witness is Mr. Frederick F. Horn, the senior vice president of Bache Halsey Stuart Shields Inc., New York City.

Mr. Horn, welcome.

Do you have someone you would like to bring to the witness table with you or are you by yourself?

STATEMENT OF FREDERICK F. HORN, SENIOR VICE PRESIDENT, BACHE HALSEY STUART SHIELDS INC., NEW YORK, N.Y.

Mr. HORN. I am by myself.

Chairman Jones and members of the subcommittee, my name is Fred Horn. I am senior vice president of Bache Halsey Stuart Shields Inc., which is a member of all the leading stock and commodities exchanges, and a wholly owned subsidiary of Bache Group Inc.

I am in charge of the commodities futures business of Bache, and as such am familiar with the recent events in the silver futures market.

In order to clear up any confusion which may exist about the effect on Bache of the recent events, I wish to emphasize at the outset that Bache has suffered no financial loss in connection with its liquidation of the silver position of the Hunt family accounts. Further, Bache has no loans outstanding relating to the Hunts and Bache has paid off the loans made to it by various banks.

I would like to comment on certain aspects of the regulatory structure in the futures markets. Based on my experience in the commodities business and my familiarity with the recent events, it is my general conclusion at this time that the present regulatory

structure constitutes an appropriate mix of governmental and self-regulatory elements, and no remedial legislation is needed.

Further, I believe that, as it turned out, the system worked satisfactorily during these events. I would, however, like to address three areas of regulatory interest affecting the futures markets.

The first concerns the setting of margins for futures contracts. We have believed and continue to believe that it is appropriate for the exchanges to set margins rather than the CFTC. As we understand it, the CFTC has taken the position that they can set margins under their emergency powers, but not otherwise.

In fact this power was exercised several years ago in the potato crises when the CFTC imposed 100 percent margins. We agree with the CFTC that it should have the authority to pre-empt the exchange margin rules in an emergency situation.

We also believe that it would be totally inappropriate for some other Federal agency such as the Federal Reserve Board to have any jurisdiction over commodity margins. As you may know, during the week of March 24, 1980, the Comex reduced margins on silver futures.

We believe this was a correct decision on the part of Comex and was helpful in bringing additional liquidity to the market and alleviating the pressures for forced liquidation of futures contracts.

This decision was also an example of the ability and willingness of the exchanges to move with appropriate speed. If, on the other hand, the CFTC, or other governmental body, were charged with setting margins on other than an emergency basis, it is very probable, in my opinion, that they could not have responded in the same manner.

Second, we believe that in the matter of setting position limits for silver commodity futures contracts, although in our view such limits are detrimental to futures trading, the authority to set limits should be in the hands of the commodity exchanges. We strongly believe that any reduction in position limits should not be imposed retroactively.

When the Chicago Board of Trade proposed regulations imposing retroactive position limits in silver futures contracts in December 1979, we expressed our strong opposition to such limits to the CFTC. Nevertheless, the CFTC approved the proposed limits and allowed them to be imposed retroactively.

We think that not only was this undesirable, but that it illustrates what may be an anomaly that occurs in various areas of the rulemaking authority of the exchanges.

We doubt that if the CFTC itself were to adopt rules concerning position limits that it could, in all cases, adopt them to have retroactive effect. This is a result of concepts of due process which may apply and limit the rulemaking authority of Government agencies.

However, the exchanges are not subject to this concept with respect to rules enacted by them. We believe it would be appropriate for the rulemaking power of the exchanges to be subject to the same due process consideration as are rules initiated by the CFTC.

The third matter we would like to comment on is the question of whether the silver futures markets should have been closed as the silver price decline reached its climax.

As you know on Thursday, March 27, 1980, we requested the CFTC to close the markets and settle the outstanding contracts. We believed this to be desirable, and that the situation, as we saw it, met the criteria necessary for them to invoke their emergency power. It was on this day that the spot price of silver reached its low point of \$10.80 per ounce having declined from \$20 per ounce 3 days before.

We did not believe the market had any liquidity left and the only solution was to close it. As it turned out there was substantial liquidity at prices in the area of \$11 and \$12 and the judgment of the CFTC and the exchanges to leave the markets open and permit them to operate was correct.

In summary, we believe that the events in the silver market from September 1979 through the present indicate that the present statutory structure is satisfactory and that the present balance of the self-regulatory authority of the exchanges and that of the CFTC worked well.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Horn. I presume you will stick around for a little while, too.

Mr. HORN. Yes; I can.

Mr. JONES of Tennessee. We appreciate your statement.

The next witness is Mr. Henry Maringer, president of ACLI International Commodity Services, Inc., New York.

Welcome. We are glad to have you with us and will be pleased to hear from you at this time.

STATEMENT OF HENRY MARINGER, PRESIDENT OF ACLI INTERNATIONAL COMMODITY SERVICES, INC.

Mr. MARINGER. Thank you, Mr. Chairman.

My name is Henry Maringer. I am the president of ACLI International Commodity Services, Inc.

ACS, a wholly owned subsidiary of ACLI International Inc., is a futures commission merchant with three offices: New York, Chicago, and Minneapolis. It has affiliated firms in London, Geneva, Zurich, Hamburg and Rotterdam, as well as commercial relationships with companies in Hong Kong, Sao Paulo and Guatemala.

ACS is a member of every futures exchange in the United States except the Mid-America Commodity Exchange and has clearing privileges on all those exchanges except the Kansas City Board of Trade. It also has member privileges on exchanges located in London, Hong Kong, and Winnipeg.

ACS trades for customers and not for the parent corporation, except for a limited amount of hedging activity. ACS is a broker and only a broker and does not trade for its own account in futures or in physicals. It prohibits its officers, directors and employees from trading for their own accounts whether at ACS or elsewhere.

The parent corporation, ACLI International Inc., is an international commodity merchant firm dealing as principals in cocoa, coffee, sugar, the soybean complex, rubber, metals and ores, seafood, and agricultural and industrial chemicals.

Mr. Chairman, I am pleased to be here today at the invitation of this subcommittee to share with you my views on the silver market

and on the need for remedial legislation concerning the commodity markets.

First, it is important to understand that the fundamentals of silver have been out of balance for a considerable number of years. Because of various Government policies, the production of silver in the United States and in the world did not expand as rapidly as did the consumption of silver. Thus, supply has lagged behind demand with a resulting upward pressure on prices.

Recent upward pressure on the silver market coincided with a general boom in commodity markets which began last year arising from the world petroleum market, general inflation, and other international political events.

From September 1979 to March 1980 the daily Comex settlement price for spot silver rose from approximately \$11 per troy ounce to a high in mid-January of \$48.70 per troy ounce. This dramatic and rapid increase in price has been the subject of much public attention and official scrutiny.

As a result of the attention focused on the silver market the futures exchanges considered and took a series of remedial actions. Comex raised margin requirements, expanded daily price limits, imposed a "liquidation only" order and adopted limits on the positions which could be held by traders. The CBOT in this period adopted similar requirements.

The impact of these self-regulatory actions by the two exchanges was quickly felt. As the cost of market entry increased, the people who could most easily afford to trade were those with established long positions which daily increased in value. Market volume decreased substantially.

To compound the problem further, many positions were liquidated, in part because of the new exchange regulations, with the result that the open interest began to decline. [See chart A.]

In short, what happened was that the silver market contracted considerably so that those persons who held contracts and wished or were required to liquidate could do so only with difficulty and at substantial cost. Thus, when commodity prices in general began to decline, due also in part to mounting interest costs, the decline in the price of silver was even more precipitous. For instance, compare the decline of silver prices to gold prices. [See chart B.]

Some persons have noted that the recent events in the silver market indicate a need for remedial legislation.

Proposals have included: Concurrent authority over futures trading to be exercised by the Securities and Exchange Commission, the Federal Reserve Board, the Department of the Treasury and CFTC; imposition of suitability requirements; and, granting to the Federal Reserve Board the authority to regulate margins.

I believe that the considered judgment of Congress in 1978 and 1974 was correct.

CFTC and CFTC alone should regulate futures trading. The creation of an additional overlapping regulatory infrastructure would not give any further protection to the public than that provided by the CFTC. The result would be extremely inefficient and would create regulatory disparities where none now exist.

Additionally, the protection to the public would suffer as the regulatory system became more and more chaotic thereby causing market quality to deteriorate.

The setting of the margin levels and their timing should continue to be left to the self-regulatory bodies. Since there is a fundamental and essential difference between the nature of margin on securities and futures contracts, any regulatory analogy between the two markets fails.

Those differences explain the lower requirements for margins on commodity trading, at least as expressed in percentage terms. The lower margin rates on commodities attract more market participants and give the markets breadth and depth.

Liquidity, so missed by the silver markets because of the higher rates, is present when lower rates are imposed, thus permitting trading to take place in a fluid atmosphere conducive to true price discovery. This is especially true of the rates applicable to hedgers.

If margin rates were set too high, they would have an adverse impact on the hedger's marketing economics and, as a result, futures would not be used by hedgers. If the margin rates are set high in order to discourage other traders, the markets lose liquidity.

It has also been alleged that the lack of a customer suitability requirement is a major disparity in the regulation of commodity futures trading as compared to securities.

The issue is not whether futures trading is suitable for a particular customer but whether the Futures Commission Merchant (FCM) has disclosed the risks of futures trading to the customer. Assuming that disclosure has been made, the FCM's obligation to the industry and to itself is to be assured that the trader has the financial ability attendant to the risk.

CFTC has created a summary document which adequately discloses the risks attendant to futures trading without giving so much data that a reader is confused by an excess of information.

I would like to call attention to an important difference between the securities and commodities markets. The FCM's are required by statute to treat and deal with the money, securities and property of a customer as belonging to the customer and to segregate it from its own funds. This is not the case in securities.

During the last few weeks of the events of the silver market, when it was quite clear that certain persons were unwilling or unable to meet margin calls, CFTC and self-regulatory bodies monitored the segregation records of FCM's deemed to be in possible financial jeopardy.

The money, securities and property of all customers was found to be secure and protected, notwithstanding that certain of the firms were reported to have suffered losses.

It should be noted that this customer protection is at no expense to the Federal Government, whereas in the securities industry, customer protection is obtained primarily through the federally sponsored SIPC.

In summary, first, it is clear that attempts to fine-tune a market can have adverse consequences for the effective operations of that market.

Second, CFTC has sufficient authority to deal with market emergencies and other contingencies, and we see no need to amend the Commodity Exchange Act.

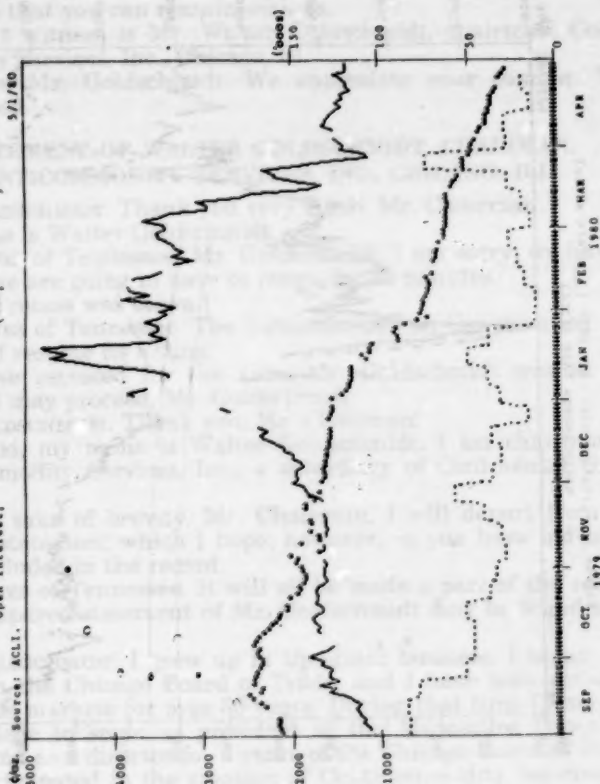
Thank you, Mr. Chairman.

[The attachments to the statement follow:]

Chart A

SILVER PRICES, VOLUME AND OPEN INTEREST

Weekly Haven cash price (—, left scale)
 Weekly volume, COMEX, all contracts (---, right scale)
 Open interest, " " " " (---, " " " ")



Because of my extensive participation in the futures industry and my concern for it, I am now pleased to be here today at your gathering.

I can also readily appreciate your concern with the industry about fluctuations that have arisen in the silver markets during the period between September 1979 and April 1, 1980. But let me warn you that the future which you have helped to create under the Commodity Futures Act (enacted by Congress) is not necessarily adverse to your interests.

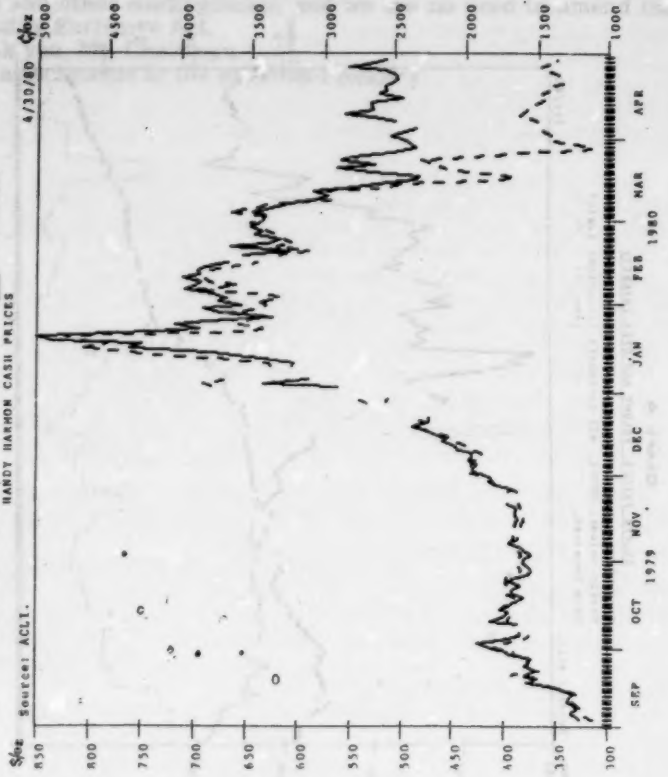
The future market system will be open to all who want the facilities that make sense for the silver market. One of the main reasons has been that the system worked that the market is not that simple, because only clearing members can do business. No participant in the system either the government or the commercial hedger will be able to take the system away. The system proved itself in 1979-1980, and it is the only one that is now used in the world. It proved itself to be better than any other system. Consequently, it

Chart B

SILVER (---, right scale) vs GOLD (___, left scale)

HANDY HARMON CASH PRICES

Source: ACLI.



Mr. JONES of Tennessee. Thank you very much, Mr. Maringer, and I hope that you can remain with us.

Our next witness is Mr. Walter Goldschmidt, chairman, ContiCommodity Services, Inc., Chicago, Ill.

Welcome, Mr. Goldschmidt. We appreciate your coming. You may proceed.

**STATEMENT OF WALTER GOLDSCHMIDT, CHAIRMAN,
CONTICOMMODITY SERVICES, INC., CHICAGO, ILL.**

Mr. GOLDSCHMIDT. Thank you very much, Mr. Chairman.

My name is Walter Goldschmidt.

Mr. JONES of Tennessee. Mr. Goldschmidt, I am sorry; we have a vote and we are going to have to recess for 15 minutes.

[A short recess was taken.]

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will resume its sitting.

When we recessed for the vote, Mr. Goldschmidt was at the table. You may proceed, Mr. Goldschmidt.

Mr. GOLDSCHMIDT. Thank you, Mr. Chairman.

As I said, my name is Walter Goldschmidt. I am chairman of ContiCommodity Services, Inc., a subsidiary of Continental Grain Co.

For the sake of brevity, Mr. Chairman, I will depart from my prepared statement which I hope, however, as you have indicated, will be included in the record.

Mr. JONES of Tennessee. It will all be made a part of the record.

[The prepared statement of Mr. Goldschmidt may be found on p. 215.]

Mr. GOLDSCHMIDT. I grew up in the grain business. I began as a runner on the Chicago Board of Trade, and I have been active in the futures markets for over 30 years. During that time I have had the privilege to serve as president of the Milwaukee Grain Exchange, and as a director for 6 years of the Chicago Board of Trade. I also participated in the creation of ContiCommodity Services, an organization which since its founding 10 years ago has emerged as one of the leading futures merchants in the United States and abroad.

Because of my extensive participation in the futures industry and my concern for it, I am most pleased to be here today at your invitation.

I can also readily appreciate your concern with the industry violent fluctuations that have occurred in the silver markets during the period between September 1979 and April 1, 1980. But let me assure you that the system which you have helped to create under the Commodity Exchange Act functioned satisfactorily under extremely adverse circumstances.

The futures market system reflects price. It does not create the conditions that make price. For me, the most salient aspect of the recent events has been that the system worked, that the market, in the final analysis, prevailed. Every clearing member met its obligation. No participant in the market, either the speculator or the commercial hedger, suffered from the failure of the system itself. The system proved itself as it has so many times in the past. It proved itself to be bigger than any participant. Consequently, we

must, and I am sure you will, be very wary of tampering with the system which has provided the hedging mechanism and price discovery function so vital to our agricultural sector and to our entire economy.

What, then, caused this unprecedented and undesirable volatility of the silver market? The silver market is truly an international market, and is particularly immune to any form of price manipulation. My lifelong experience as a trader and as a hedger in futures markets leads me to conclude that the dramatic rise and fall of silver prices was largely a response to the fundamental market forces.

It is now common knowledge that individuals with substantial means began to accumulate large amounts of silver in 1979. This accumulation occurred during a period not only of high inflation but of expectation of even greater inflation, a period when the return on capital was far below the inflationary rate, a period of relatively low interest rates, a period of unsettling international events such as Iran and Afghanistan, and a period of high currency fluctuations. All these factors make it attractive to own precious metals, particularly gold and silver, rather than cash.

It is not surprising that both silver and gold prices peaked on the same day. Given the interplay between relatively low interest rates and soaring inflation against the background of international crisis, gold and silver were a logical hedge for individuals with substantial assets. Markets are not perfect. A move in excess both on the up side and the downside, as the silver market began to rise dramatically, the exchanges became concerned, and took steps to prevent excessive speculation. They have many tools available to them. The one they used first was to substantially increase margin requirements.

In my opinion, as they repeatedly raised the margin requirements, they made the market less liquid by restricting participation to those who either had very substantial means or had made a lot of money in the market by being on its long side, and could use those profits to meet the higher margins.

The higher margins stood as a barrier to increased participation by forces on the short side of the market, not only the speculative community, but the hedges as well.

Our experience has been that markets which have broad and extensive speculative participation are the most valuable ones for hedging. The opposite and converse is also true. Hedges are reluctant to participate in a market that is volatile and illiquid. A sharp rise in margin requirements unintentionally increasing the volatility and liquidity of the silver market had the effect of driving out the hedgers. So, contrary to popular belief, that raising margins will reduce price levels, I submit to you that the excessive use of that tool caused the silver market to peak higher than it would have otherwise if the margin tool had been used with more restraint.

Another consequence of the action taken by the exchanges was that the nearby and spot silver sold continuously at a price well below the distant months. Even with the cost of carrying silver, it was always attractive to take delivery and hold silver rather than sell or switch to distant months. I am convinced—as a matter of

fact I know—that many of the participants would not have taken as much physical silver, and would either have divested themselves of some of their holdings or moved them to deferred months, had the market forces been permitted to operate freely.

Just as I believe that the intervention of the exchanges and the unintended effect of intensifying the natural rise in the silver prices, so, too, it had the effect of accentuating the decline. When the Comex finally adopted the extreme measure of permitting trading for liquidation only, the Federal Reserve Board and Government, concerned by inflation, were tightening the money supply, inducing interest rates to climb to unprecedented levels.

This led to a reversal in investors' attitude. Instead of converting cash into goods, they began converting goods into cash. This psychology affected not only the silver market but most of the other commodities in which we deal. The initial drop in the silver market was therefore the result of fundamental economic forces applied to a market made thin by actions and concerns of exchanges.

This triggered what we now know was a forced liquidation of one of the largest participants in the history of futures market trading—causing the dramatic decline in prices. This, in my opinion, is a thumbnail sketch of what has occurred.

I would like to address a few of the questions and concerns about what should be done to prevent this from happening again. Two of the issues: First, should the power to set minimum margin requirements on futures contracts, which is now held by the commodities exchanges, be given to the CFTC? Second, should the power to set speculative position limits for silver be exercised by the CFTC?

As to margins: As the members of this subcommittee are aware, margin requirements perform a function in a commodity market distinctly different from their function in the securities market.

In commodities, by contrast, the margin functions as a security deposit, not as a source of credit. On this subject I also endorse the excellent paper recently prepared by Dr. Mark Powers, previously referred to.

In the light of the function of commodity margins, I believe that it would be a mistake to shift margin setting authority from the exchanges to the CFTC. As I have already stated, the tool of raising margins was, if anything, overapplied by the exchanges. It is not reasonable to assume that, had this authority been lodged with the CFTC or any other Government agency it would have been more judiciously exercised.

It is always easy to look back and conclude that one might have done something differently, but I doubt whether any agency necessarily further removed from, and with less understanding, of the marketplace, would have done better than the exchanges.

As far as position limits are concerned, we have lived with them in the agricultural futures markets for years. Ample authority exists in the CFTC and self-regulatory exchanges to apply those measures to the metals markets. Here, in retrospect, they might have been applied to silver too late, but this is a delicate question of judgment. Position limits will be counterproductive unless they are set at levels sufficiently high not to impair liquidity and will be ineffective unless they are low enough to prevent excess accumulation of futures positions.

What I am saying is that such limits must be tailor-made for each commodity and the authority should remain in the hands of those closest to the marketplace to strike the right balance. If the exchanges default on their responsibility, the CFTC already possesses ample authority to set limits on speculative positions. When they are established, however, such limits should not be applied retroactively to existing positions, as they were by the exchanges here, but should be known in advance to all the market participants.

In summary, my observations are that the market responded to economic forces. It reflected the value of the underlying physical commodity. Yes, like all markets do, it moved to excess. It corrected itself, but, again, to excess. The price movement was unacceptably severe. However, sufficient regulatory authority does exist with the exchanges to prevent abuses, with ample oversight authority by the CFTC.

Thank you, Mr. Chairman. I thank you for the opportunity to participate in these debates.

Mr. JONES of Tennessee. Thank you, Mr. Goldschmidt.

I suppose you can wait until we hear the other witnesses.

Mr. GOLDSCHMIDT. I will be pleased to.

[The prepared statement of Mr. Goldschmidt may be found on p. 215.]

Mr. JONES of Tennessee. The next witness is Mr. David Johnston, of the E. F. Hutton Co., New York.

Welcome, Mr. Johnston. We are delighted you could come and be with us today. Do you have someone with you?

Mr. JOHNSTON. No, I do not.

STATEMENT OF DAVID T. JOHNSTON, DIRECTOR AND SENIOR VICE PRESIDENT, E. F. HUTTON & CO., INC., NEW YORK, N.Y.

Mr. JOHNSTON. Mr. Chairman, members of the House Agriculture Subcommittee on Conservation and Credit, my name is David T. Johnston. I am senior vice president, commodities, and a director of E. F. Hutton & Co., Inc., New York.

In my judgment the apparent crisis in silver has now passed without major damage to any except those who made poor market judgment. There were no bankruptcies of brokerage firms, no customer losses except those due to poor market judgment, no bank failures. Markets remained open and the course of prices was in accordance with the law of supply and demand. The silver situation, however, arose in a most unusual period in which monetary inflation was rampant, not only in the United States but in the entire world.

The timing of oil price increases, the invasion of the U.S. Embassy in Iran, the invasion of Afghanistan, then the imposition of credit controls and the move toward budgetary balance in the United States gave impetus to the rise and subsequent fall of silver prices. Futures prices are usually responsive to developments and provide important early warning indications to farmers and producers, as well as consumers, of factors affecting supply or demand, such as the firmness in U.S. wheat prices on possible drought in the northern United States and Canada.

The question at hand, of course, is, should the regulatory structure and power be revised, and if so, how? Numerous proposals

have been made to shift part of the regulatory process from the CFTC to other agencies, to give the CFTC or some other Government agency greater control over margins, position limits, et cetera. Whenever a crisis situation develops in the futures markets, regardless of the cause, there is an instant clamor to find a scapegoat, and also to write new rules or regulations designed to prevent a recurrence of the specific problem that appears to have led to the crisis.

From my standpoint, it is imperative for markets to be regulated fairly and firmly if they are to continue to serve the function for which they were created, a function which has been needed in a world beset by a growing population and advancing rates of inflation.

As the futures markets have grown over the past 25 years, and particularly the past 10, so has the regulatory structure.

I have had a unique opportunity to observe, and to participate to a certain degree in the development of the regulation and supervision of the futures industry.

In my judgment the regulatory structure within the industry has grown and improved immensely in the past 10 years. The replacement of the CEA by the CFTC was a major step in the right direction. At the same time, the regulatory and supervisory staffs of the exchanges have expanded greatly.

Governing boards of exchanges have had to adapt to the problems caused by huge increases in volume and open interest in order to maintain fair and honest markets. The process of building a regulatory structure in an industry where growth over the past 10 years has been over 20 percent a year cannot take place without problems.

The problems that have developed in recent years inevitably have resulted in improved regulatory procedures which have not affected the freedom of the marketplace.

The current regulatory process provides that the industry, operating under the broad provisions of recent legislation, be regulated by the commodity exchanges with oversight by the CFTC. While there are differences of opinion between the industry and the CFTC on individual items, the resulting process has worked well. The CFTC has been in existence for 6 years, and it has taken some time for the Commission to understand as much as it does about what the futures markets are about and how they must operate if they are to be efficient. During the same period exchange capability in the regulatory area has improved substantially. The successes are not noted, only the occasional slips are observed.

The futures markets are unique. They are not comparable to the cash markets for raw materials, or to markets in securities. Nor can the regulatory processes be the same. Regulation of the futures industry and futures markets requires expertise and understanding as to their function, how they must operate if they are to fulfill their function, and what is required to keep the markets fair and honest.

The exchanges have the expertise, the knowledge, and the incentive to do the best possible job. After all, failure to regulate efficiently can lead to inefficient markets, with resulting increased costs to commercial users, as well as to reduced brokerage fees to

both floor and brokerage communities. The silver industry can provide extensive testimony to the accuracy of this.

Futures markets have evolved for the purpose of permitting the shifting of existing risks. The only way markets can perform their function is to attract speculative capital to seek to assume these risks and help provide for fluid markets.

All futures markets, whether it be in agricultural commodities, metals or other industrial commodities, financial instruments, or any other type of asset in which substantial risks are involved, are inherently the same. The problems of regulating such futures trading in one area are about the same as another, but they differ considerably from the problems of regulating trading directly in the underlying asset.

It makes no sense to have different regulations just because the underlying assets are different. To do so would interfere with, and not help, the U.S. Government's ability to provide regulatory oversight over this industry. Fragmenting of regulation over a number of agencies would not only be inefficient but costly, and would entail serious risks of adverse interference in free markets.

Consequently, I urge that regulation of the industry continue as it is presently. The CFTC should continue to have oversight over the industry regulatory bodies, basically the exchanges and hopefully an industry body to regulate FCM's. The CFTC has the power to review exchange procedures to make certain they are adequate to minimize the possibility of actions of individual traders, or groups of traders, where such action could be construed as manipulative in character, or which could lead to loss of market liquidity. The CFTC should work with exchanges to make certain that exchange rules and regulations permit appropriate exchange action in such instances.

At the same time, the CFTC should also make certain that exchanges have procedures for setting and reviewing margins in line with price volatility, percent of contract value, and other pertinent market factors. In order for markets to perform efficiently, margins must be set under normal circumstances at levels sufficient to attract speculative activity as without speculative activity futures cannot perform their risk-transferring functions.

On the other hand, margins at times must be high enough to restrict speculative activity when such activity tends to exceed normal levels, or could create a dangerous market situation. The exchanges have the expertise and knowledge to set margins and adjust them as rapidly as needed.

No agency of the Government, and particularly those not experienced in futures trading, could conceivably be as responsive to the needs of the marketplace for speculative capital, as well as to the inherent risks within the futures industry, as the governing bodies of the exchanges.

In summary, I suggest that existing legislation is adequate to provide for sensible regulation of the industry, and that problem areas can best be handled by improved communication between the CFTC and the exchanges.

Thank you for the opportunity to appear before this committee. I will be pleased to answer any questions you may have.

Mr. JONES of Tennessee. Thank you very much, Mr. Johnston, for being here, and for the testimony. We will ask you to remain until we hear the last witness.

Our next and last witness as far as my schedule shows is Mr. Jerry Spielman, commodity division, Merrill Lynch, Pierce, Fenner & Smith, Inc., New York.

Welcome, Mr. Spielman.

**STATEMENT OF JEROME M. SPIELMAN, VICE PRESIDENT,
MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.**

Mr. SPIELMAN. Thank you, Mr. Chairman, distinguished members of the subcommittee.

My name is Jerome M. Spielman. I am a vice president of the commodities division of Merrill Lynch, Pierce, Fenner & Smith, Inc.

The subcommittee has asked the brokerage community to evaluate the recent events in the futures markets, and you have asked whether additional remedial legislation is warranted. As discussed below, we do not believe additional legislation is necessary or appropriate. Federal regulators already have strong remedial powers at hand. This subcommittee I know will be considering how those powers can be used more effectively in the future.

It has been said that the price volatility we have seen recently in the silver market was fueled by a few large speculators seeking to corner that market. That is open to question. It is our view that other factors, which were reflected in the metals markets throughout the world, played a fundamental role in the volatile prices and the large speculative interest in commodities such as gold and silver. During the second half of 1979, speculative investor interest focused on the metals markets, particularly gold and silver. The prices in both of those commodities soared as investors sought hedges against inflation, general economic uncertainty, and the potential consequences of world events such as the seizure of the diplomatic personnel in Iran and the Russian invasion of Afghanistan.

This year speculators in the silver market encountered severe problems as the result of increased regulatory controls such as the imposition of position limits; increased, almost prohibitive, margin requirements, and other restraints such as limiting trading to liquidation only. Those speculators also encountered soaring interest rates and credit restraints, all of which helped to dry up credit sources and cause severe liquidity problems for large silver trades.

All of these factors contributed to the recent events in the silver markets. Although we tend to concentrate on the efforts of speculators on the long side of the market, the fact is that no one could buy silver futures unless there was a seller, that is a hedger or someone who is willing to go short in the expectation that they would benefit from a market decline.

We all agree that the commodities markets serve a vital role in our Nation's economy. Those markets allow producers and users to hedge their risks and they provide a convenient, readily recognizable means of identifying the price of a given commodity at any given time. This mechanism permits producers, merchants, users and many others involved in industries which are based upon

commodities of all sorts to carry on their commerce in an orderly way and plan for the future with a reasonable degree of assurance.

Speculative interest in these markets is vital to their continued existence. For it is the speculator who assumes the hedger's risk. It is also the speculator who contributes liquidity and depth to the markets. Without speculators there would be no futures markets, and our economy would suffer if producers and users were to lose this beneficial mechanism.

Margin levels are vital to market participants, and margin requirements must be flexibly imposed and changed as market forces require. Indeed, in order to monitor margin levels, the exchanges must conduct day-to-day surveillance, and numerous changes are often made in margin requirements by the exchanges.

We believe that the present system provides the flexibility which is necessary to regulate markets, which by their nature are volatile and composed of contracts which are short-lived. It has been suggested, for example, that a Federal agency such as the Federal Reserve Board establish margin requirements for commodities as is presently done with securities. This proposal overlooks the essential differences between the securities and commodities markets and assumes a capability for speedy and informed action, which we believe would be a most difficult assignment for an agency of the Federal Government.

H.R. 7183, introduced by Congressman Glickman, provides for residual authority in the CFC to set margins in the event market conditions require. We believe this bill is preferable to the proposals we have heard for Federal agencies to set margin requirements in all instances. Nevertheless, we do not believe this additional authority is needed because the Commodity Futures Trading Commission presently has broad regulatory authority sufficient to meet any market conditions.

For example, it may impose position limits on futures contracts, where necessary. The Commission also has broad regulatory authority to act where it believes a market emergency exists. None of those tools was used during the recent events in the futures markets, and so we do not see a need for additional regulatory powers when existing ones have not been shown to have been inadequate.

In sum, we do not believe that the recent events in the silver futures markets have established a need for additional legislation. We, of course, share fully the subcommittee's concern over those events. We believe, however, that the Commission already has adequate authority to take action should it believe that large investors or other forces are unduly impacting the marketplace.

We also believe that the exchanges have acted responsibly, and we are confident that they will continue to meet their obligations in a way which will prevent such problems in the future.

Mr. JONES of Tennessee. Thank you very much, Mr. Spielman.

That does conclude the agenda of witnesses that we have this afternoon. So I would like to ask Mr. Spielman, if you will remain, we will ask the others to come forward who have been heard this afternoon, Mr. Clagett, Mr. Horn, Mr. Maringer, Mr. Goldschmidt, Mr. Johnston.

I want to congratulate the witnesses who have been heard because you have all abided by the rules and have taken the time

necessary. For that reason we are wrapping this up on time. That is not always the case.

Mr. Horn, I have a question or two I would like to ask you and we will abide by the 5-minute rule on subcommittee members also on asking questions.

Would you describe your relationship with Mr. Volcker, Chairman of the Federal Reserve?

Mr. HORN. Our relationship to him?

Mr. JONES of Tennessee. Yes, sir. Do you have any or not?

Mr. HORN. I have no relationship with him. In fact, I have never even met the man other than seeing him here.

Mr. JONES of Tennessee. Put it another way, Mr. Horn.

I have heard reports that Bache requested Chairman Volcker to halt futures trading in silver. Is there anything to that?

Mr. HORN. Yes, sir. Our chairman knows Mr. Volcker and Bache somewhere during that week of June 24, he did in fact call Mr. Volcker and asked that he could use his influence to induce the CFTC to close down the market and sell the contracts.

Mr. JONES of Tennessee. That leads me to the question I really want to get to: Why was the request made to Chairman Volcker and not the CFTC, since the CFTC is the only agency with authority to make that decision?

Mr. HORN. Requests were made to both.

Mr. JONES of Tennessee. Were made to the CFTC also?

Mr. HORN. Oh, yes.

Mr. JONES of Tennessee. They were made to Chairman Volcker and to the CFTC at the same time?

Mr. HORN. Yes.

Mr. JONES of Tennessee. That clarifies some of the questions that we have been hearing and I am glad to know that you asked the CFTC also.

Mr. Goldschmidt, beginning last fall there were a number of news reports linking Conti and one of its officers, Morton Waltuch, with major positions in Comex silver futures. It was frequently reported that Waltuch was buying large quantities of silver futures for Conti customers and that the price of silver would jump dramatically whenever Mr. Waltuch appeared on the trading floor. Can you explain why this happened?

Mr. GOLDSCHMIDT. I can't explain how the prices jumped up. I can—

Mr. JONES of Tennessee. Can you explain whether that is a fact or not?

Mr. GOLDSCHMIDT. Well, let me say this: that yes, Mr. Waltuch is an account executive of ContiCommodity Services who had a number of clients who became active in the silver market during that time and he does buy silver on the trading floor for them.

Mr. JONES of Tennessee. Did Conti have some foreign clients in silver futures trading in the past year?

Mr. GOLDSCHMIDT. Yes; we did.

Mr. JONES of Tennessee. Would you name them?

Mr. GOLDSCHMIDT. Well, I can't name them all excepting I can name I believe what you are interested in are the principal ones and the most prominent client we had was the Banc Populaire of Switzerland. We had additional individual investors, one or two

which were also prominent. One, Mr. Nahas of San Paolo, Brazil, and there is certainly Mr. Fusstock of Paris, France. Those are the principal, the largest of the customers that we had.

Mr. JONES of Tennessee. Were these foreign clients in any way trading in concert with the Hunts?

Mr. GOLDSCHMIDT. I am not aware of that.

Mr. JONES of Tennessee. Would you care to supply the subcommittee, if you do not have the other foreign clients, would you care to supply those or would you do it at a later date?

Mr. GOLDSCHMIDT. The list of all of our foreign accounts?

Mr. JONES of Tennessee. Yes.

Mr. GOLDSCHMIDT. In the silver market?

Mr. JONES of Tennessee. Yes; in the silver market.

Mr. GOLDSCHMIDT. Certainly.

Mr. JONES of Tennessee. We would appreciate it if you would. [The information requested follows:]

CONTI COMMODITY SERVICES, INC.,
Chicago, Ill., June 30, 1980.

Hon. Ed JONES,
Chairman, Subcommittee on Conservation and Credit,
House of Representatives, Washington, D.C.

DEAR MR. JONES: In connection with the appearance by Walter Goldschmidt before your committee on May 21, 1980, you requested that we provide you with certain information regarding large foreign silver purchasers through ContiCommodity Services Inc. There follows a list of those foreign customers of Conti who held, for the period of September 1979 through March 1980, a CFTC reportable position: Banque Populaire Suisse Geneva; Naji Robert Nahas; Societati Banca Svizzera; Gillian Financial Inc.

Again we thank you for the opportunity of participating in the committee hearings.

Very truly yours,

GLEN F. HACKMANN, Chief Counsel.

Mr. JONES of Tennessee. Did Conti voluntarily cooperate with CFTC and Comex in their inquiries into the silver markets?

Mr. GOLDSCHMIDT. Yes. We always cooperate with the regulatory agencies in all respects.

Mr. JONES of Tennessee. In other words, what you are saying is you did tell CFTC and Comex all that you knew about the ownership, and control of the silver accounts that Conti was carrying?

Mr. GOLDSCHMIDT. To the extent that we were requested to do so; yes.

Mr. JONES of Tennessee. Did you promptly and voluntarily provide that information?

Mr. GOLDSCHMIDT. To the CFTC as requested?

Mr. JONES of Tennessee. Yes.

Mr. GOLDSCHMIDT. Yes.

Mr. JONES of Tennessee. Did Conti at some point place limits on the size of positions it carried in silver for customers?

Mr. GOLDSCHMIDT. Yes; we did.

As a matter of fact, early in September we issued an order to our system, to our account executives that we did not wish that our clients increase their positions in the silver market; at that time we referred to the current futures months, I believe it must have been September and December futures.

Mr. JONES of Tennessee. Did it at any time ever occur to you that, or to Conti, that some of these accounts might be involved in an attempt to manipulate the silver prices?

Mr. GOLDSCHMIDT. No.

Mr. JONES of Tennessee. Thank you so much. My time has expired.

Mr. HANCE, you have 5 minutes.

Mr. HANCE. I would ask this question of all the gentlemen.

This morning in asking questions with the members of the Commission, I certainly had reservations about margin requirements. I am really opposed to any change simply because the small investor really is the one who is going to be taken out of the market and I have a lot of my district that hedge cattle. So I understand that aspect.

Prior to being a Member of Congress, I used to hedge, but I heard someone say there was a conflict so that took me out of the market. But something does concern me.

If legislation were introduced that would do away with the limits that we now have on grains and do away with all those grains, cattle, all your commodities, but it had a percentage, that no one, say, could own more than 10 percent or 20 percent of any one commodity, any 1 month like April cattle or whatever; would that be good? It is rare, I guess, that you ever would have a client that would have more than 10 percent of the market on any month. If that is not rare, please correct me. I would like to hear from each of you as briefly as possible whether you think it would be good or bad, just your feelings on it.

Mr. Spielman?

Mr. SPIELMAN. Off the top of my head, I would say that position limits as a percentage of the market, while conceptually there might be some merit to it, I think there might be difficulty in implementing it on an ongoing basis, particularly as market conditions change. Just as a very brief example, it would be possible that someone had, we will say the equivalent of 10 percent of the open interest and then the open interest declined, how would you treat that individual participant at that point?

Mr. HANCE. What about doing away with the limits on say the 3 million bushels of wheat and just not have any limits, volume limits?

Mr. SPIELMAN. I personally am in favor of reasonable speculative position limits.

Mr. HANCE. Mr. Goldschmidt?

Mr. GOLDSCHMIDT. I believe that the method that you prescribe, while I think the objective is to set reasonable limits—and I think in my prepared remarks I mentioned it must be high enough not to impair liquidity and low enough not to cause excessive speculation, I think they would reach that objective; I believe that.

However, just like Mr. Spielman, I think it would be a little bit difficult to watch and to guide. Particularly the problem would arise in the spot month, because sooner or later someone has to have 100 percent. So I think the idea has merit, I believe we should think about it some more and maybe with some exceptions—the concept is satisfactory except I need implementation and watching it may be difficult and the spot months would have to be excluded.

Mr. HANCE. If you compared that proposal with margin requirements proposal, which would be most preferable to you?

Mr. GOLDSCHMIDT. With the margin? I think I have also indicated that I think that the fact is that in agricultural markets we have lived with limits and they have worked out reasonably well.

Mr. HANCE. I mean increasing of margin requirements.

Mr. GOLDSCHMIDT. In lieu of increasing margin requirements?

Mr. HANCE. Which would you rather have?

Mr. GOLDSCHMIDT. There is no question, I was going to say, I think the limit system that we have in agricultural products could be extended to the metal markets and they could be applied and if they were applied I think the method that you are indicating is probably somewhat preferable over what we have, excepting that the watching and the implementation and what the limits should be I find somewhat difficult to cope with.

Mr. HANCE. Mr. Maringer.

Mr. MARINGER. I must agree with my colleagues. I think that the implementation, the technical aspect of controlling a particular position for any one particular client in relationship to the open interest could be difficult. I think it warrants further study. I would say it is premature to come to any real conclusion at this time, but I think it certainly warrants study.

Mr. HANCE. Thank you.

Mr. CLAGETT. I agree with my colleagues in their statement that possibly it would be a good idea to have limits on end trading.

Mr. HANCE. You would have to make sure, I can see the point you have made, that with the implementation of it, it would be—

Mr. CLAGETT. It would be very difficult and would have to be studied very carefully before the limits were put in.

Mr. HANCE. Mr. Johnston?

Mr. JOHNSTON. I am basically opposed to position limits as such.

Mr. HANCE. You would rather have margin requirements?

Mr. JOHNSTON. I am definitely opposed to the CFTC setting fixed position limits and I think it is wrong for position limits on corn to have been 3 million bushels when the crop was 4 billion bushels and today when it is 7 billion bushels to still be 3 million bushels.

I believe the responsibility for supervising the trading, which would include the question of both position limits and margins, should be at the exchange level. I think the exchanges should have the authority to do either or both, whichever they feel is necessary to see that markets are kept square.

I think that the whole responsibility should be put on the exchanges and that the CFTC should have oversight.

Mr. HANCE. I understand your position on that, but my question is, if you had the margin requirements as what Mr. Stone would advocate, would you rather have that or would you rather have the example that I gave of doing away with any volume limit and then having total percentage, maybe 10 percent, if those were the only two choices?

Mr. JOHNSTON. If those are the only two choices?

Mr. HANCE. I know what your main choice is and I understand that, but I am asking you between those two?

Mr. JOHNSTON. Ten percent.

Mr. HANCE. But the margin requirement would be the worst?

Mr. JOHNSTON. Yes.

Mr. HANCE. Thank you.

Mr. Horn?

Mr. HORN. I think it would be a mechanical nightmare to try to implement the type of system that you are referring to; other people have suggested it in years gone by. When you think of the difficulties they alluded to, for the benefit of you gentlemen, what it would mean is every time the open interest expanded or contracted, each individual's clients' position would have to expand or contract if they were in any—in addition you have the added problem he might have positions in different firms.

I think from the point of monitoring and implementing it would be virtually impossible. I think we, as Walter Goldschmidt has indicated, have been able to live with position limits in years gone by, even though I agree with Dave also; the position limits that we have had on grains and other commodities which were essentially established in 1936 are totally unrealistic. They had no rhyme or reason when they were established at that time in relationship to the volume of trading in futures, the size of the crops.

Mr. HANCE. Let me ask one last question. How many of you have ever had or is it very normal for you to have a client that owns 10 percent of the market in any month other than the last month? That is highly unusual, isn't it, highly unusual.

Mr. HORN. Yes, except in the delivery month.

Mr. HANCE. That is what I said.

Mr. HORN. I would say generally yes.

Mr. HANCE. That is highly unusual?

Mr. JOHNSTON. Yes.

Mr. HANCE. Thank you very much.

Mr. JONES of Tennessee. Thank you, Mr. Hance.

I now yield 5 minutes to the ranking member of the subcommittee, Mr. Madigan.

Mr. MADIGAN. If I could just pick up on that last question. I understood Mr. Horn to make an exception and I thought I understood you to say except in the delivery month, and I took that to mean that it would not be unusual for you to have a client who would have 10 percent of whatever it was at the end of the delivery month called for in the contract.

Mr. JOHNSTON. As you get into the delivery month, for every long there has to be a short, and the only way contracts are ultimately completed is an old long liquid, an old short covers, or a long delivery and short covers.

As you get down to the end of the delivery period you may have a situation where there is a small number of contracts outstanding, maybe 10 contracts left in the month, if you own one of them, you own 10 percent—or you may have two.

Mr. MADIGAN. Or in the case of perhaps anything other than grain, the only people who are going to own it at the end of the delivery term are the people who have a use for it, is that not correct?

Mr. JOHNSTON. That is correct, generally.

Mr. MADIGAN. Because you said there is a long side and a short side, I would like to focus a little attention on that if I might, because we are dealing with the Hunts in this situation and we are

dealing with a set of circumstances that ultimately contributed to their losing some amount of money. I would assume, and it is just an assumption, that because they are borrowing \$800 million it would be reasonable to conclude that they lost at least \$800 million. But as you point out, there is a long and a short, there are two sides on every transaction.

I assume that to mean that if somebody lost \$800 million, somebody made \$800 million, is that not correct?

Mr. HORN. That is correct.

Mr. MADIGAN. Mr. Horn says it is correct, Mr. Johnston says it is not correct.

Mr. HORN. We do not always agree. It is correct in the sense if somebody does lose money, somebody else makes it, whether it be a speculator on the other side or a hedger.

Mr. MADIGAN. Let's see if we can establish who knows who did what and when.

Mr. Clagett, if the Commodity Futures Trading Commission knows the position of the Hunts in the silver market, knows that position to be long, and knows by how much they are long in the silver market, then they must have had access to all the transactions in which the Hunts were involved; is that a reasonable assumption on my part?

Mr. CLAGETT. They could get a report on all the transactions.

Mr. MADIGAN. And would that report show who was on the other side of each of those transactions?

Mr. CLAGETT. Not that report in itself, it would not.

Mr. MADIGAN. Would they have access to a report that would show that?

Mr. CLAGETT. Well, I think what they call a survey could be made in which that information could be sought. It would be very difficult to get the other side of all transactions. I think it could be done.

Mr. MADIGAN. But you think it would be difficult?

Mr. CLAGETT. Yes, sir.

Mr. MADIGAN. More difficult than getting the Hunt side?

Mr. CLAGETT. Yes, sir.

Mr. MADIGAN. Is that because Hunt is just a four-letter word?

Mr. CLAGETT. I surmise that the Hunts traded through a relatively small number of firms.

Mr. MADIGAN. I see your point.

Mr. CLAGETT. I think their trades would be easier to locate and to tabulate.

Mr. MADIGAN. But that trade, which is so easy to locate and tabulate, has somebody on the other side of it?

Mr. CLAGETT. Yes, sir.

Mr. MADIGAN. And that transaction had to take place through that firm which was representing the Hunts?

Mr. CLAGETT. Well, that side of the trade would have to be with that firm, but the other side could have been through maybe a hundred firms and those hundred firms could have had hundreds of customers that were on the other side.

Mr. MADIGAN. I have a note here provided by staff that says the Daily Trader report shows both long and short positions.

Mr. CLAGETT. That is correct.

Mr. MADIGAN. So it is not so hard if it is in a daily report?

Mr. CLAGETT. I think it is hard, sir, and I do not think that report would show by name each customer on the other side.

Mr. MADIGAN. If the Commodity Futures Trading Commission decides to urge the Chicago Board of Trade or the New York Commodity Exchange to take some measure in response to what they have identified rather euphemistically this morning as their concern without identifying to the subcommittee what that concern was—Mr. Stone continued to talk about his concern and communicating his concern to the two boards and asking the two boards to take some action to address his concern—other than raising the margin requirements, what actions were available to them, that Mr. Stone could reasonably anticipate that they would take?

Mr. CLAGETT. Well, I am not familiar with what each of the exchanges did in detail, but I do recall hearing and reading that the exchanges did have trading for liquidation only. In other words, those people that were in the market, after a certain time—

Mr. MADIGAN. You are right.

Mr. CLAGETT [continuing]. Could trade only to liquidate their positions.

Mr. MADIGAN. So those things done by the exchanges in response to the concerns of Chairman Stone, liquidating, increasing margins—I guess from \$1,000 a contract finally up to \$75,000 a contract—would not those two things have the effect, could I not reasonably expect that those two things would have the effect, of depressing the price of silver?

Mr. CLAGETT. It would decrease the activity, volumewise, in the market and it may or may not depress the price.

Mr. MADIGAN. In fact, did it?

Mr. CLAGETT. I am not sure, sir.

Mr. MADIGAN. Something did, though?

Mr. CLAGETT. Something did, yes, sir.

Mr. MADIGAN. But you are not willing to say that it was that?

Mr. CLAGETT. Only because I am not sure.

Mr. MADIGAN. Are any of you gentlemen willing to respond to that?

Mr. GOLDSCHMIDT. As a matter of fact, I said quite the opposite in my statement. I said the higher margin caused the silver market to peak at a higher level than it would have done otherwise.

Mr. MADIGAN. Well, I was not here for your statement and I apologize for that. I was back talking on the telephone.

What caused the price of silver to go down, in your statement?

Mr. GOLDSCHMIDT. Well, I think the thrust of my discussion was that the basic fundamental forces were at work when certain tools were applied, which accentuated that move both on the up side and the down side. In other words, fundamental forces that made it move up, when they increased their margins, actually made it go higher than it would have gone and consequently when the tools were applied on the downward side, when people who had assets converted them into cash, it also precipitated that fall to deeper than it might otherwise have been.

Mr. MADIGAN. Mr. Chairman, may I ask one other question?

I apologize to the committee for going over my limit. But I have tried very hard as a member of this committee to understand this stuff for about 2 years.

Mr. Goldschmidt, it doesn't help me to have you speak to me about basic fundamental forces and certain tools being applied because I don't know what you mean by that.

I don't know what the tools were and I don't know who applied them and who got them applied to them.

Mr. GOLDSCHMIDT. I apologize, excepting I thought I covered it in my statement. I don't know whether you want me to repeat that. I would be glad to discuss it with you.

Mr. JONES of Tennessee. Without objection, let's allow Mr. Goldschmidt to do that.

Mr. MADIGAN. Thank you.

Mr. GOLDSCHMIDT. Well, I am doing it now from memory rather than from my paper. I think the gist of what I was trying to say, sir, was the fact that interest rates did not reflect the inflation rate, the anticipatory expectations of inflation were high, there were many things in the fundamental side of the silver market which gave cause for it to go up.

Any speculator who happens to catch that move will be rewarded and I don't care how big you are, if you are going to trade against fundamental forces, sooner or later you are going to be punished as a speculator.

The same is true when it finally collapsed. I think when the market collapsed, the market had already been made so thin by, as you mentioned, \$75,000 margins, liquidation only, all the tools that were used that have been mentioned in this room, then the impact of this liquidation, together with the high cost of money, where all of a sudden it was much more attractive to owe money than cash in the expectation of the inflation rate was less than the interest rate, this caused the whole fundamental shift in the whole psychology of the speculator.

That, applied to a very thin market, caused the initial decline. The big move downward then was a forced liquidation, but the initial decline of silver, let's say, from 50 down to 25 or some such thing, was caused by fundamental forces applied to a thin market.

I hope that answers the question.

Mr. MADIGAN. My time has expired. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Madigan. Thank you, Mr. Goldschmidt.

I now recognize Mr. Richmond for 5 minutes.

Mr. RICHMOND. Thank you, Mr. Chairman.

Gentlemen, I would like to continue discussing the area of conflict of interest. I am much more worried about the problem of conflict of interest in the commodity industry than I am about this particular silver incident.

Many of you, I assume, are members of boards of either Comex or the Chicago board, are you?

Mr. JOHNSTON. Yes.

Mr. RICHMOND. You are the same people who run commodities firms, you are members of the boards, you are the same people who set margins and in many cases you are the same people who trade on the floor either for yourselves or for clients.

Now, Mr. Horn, Mr. Johnston, Mr. Goldschmidt, Mr. Maringer, Mr. Spielman, do you feel there is any conflict of interest involved in being on the same side of a fence at the same time?

Who would like to answer that question? We haven't heard from Mr. Maringer. He represents a very big firm.

Mr. MARINGER. I would like to start by saying that I am not a member of any of the boards of any of the exchanges.

Mr. RICHMOND. No, Mr. Maringer. However, I think we can all agree that many people like you head the commodity firms and sit on boards which run the exchange.

Mr. MARINGER. Yes.

Mr. RICHMOND. We also set margin accounts and trade for themselves and for other investors. All of this is done simultaneously. I would like to ask you six gentlemen if you feel there is a conflict of interest, and, do you feel that perhaps we need some new rules or new legislation?

Mr. MARINGER. Well, this has been a fact for many years, ever since the industry has been in existence. I cannot sit here and judge whether there is a conflict of interest. I am not aware of any conflict of interest. Certainly it has not been brought to my attention.

Mr. RICHMOND. Do we have that same situation in the security industry?

Mr. MARINGER. I don't know, I presume not. But I must say that the industry has had this in effect as I said, for many, many years. We have not seen, and I cannot particularly personally see any conflict of interest, none has been brought to my attention.

Mr. RICHMOND. Mr. Spielman, you are the head of the largest investment firm in the world, you are associated with the largest investment firm in the world, Merrill Lynch. Do you feel there is any conflict of interest in wearing many different hats at the same time?

Mr. SPIELMAN. There is, I think there is room for potential conflicts of interest.

Mr. RICHMOND. Tell me about them.

Mr. SPIELMAN. It is possible that some members of these commodity exchange boards do have positions; it is possible that some do. But then I think you have to look at the, we will say the rules and bylaws of the various exchanges. I believe in one case—thinking from memory, specifically the Chicago Board of Trade, I believe in their board deliberations, among other things, where appropriate, board members are either asked to disclose their positions or abstain themselves from deliberation or vote.

I think most importantly, regardless of the exchange, that the board members are responsible persons.

I think that also reflecting on Comex, certain actions were taken which were really designed to prevent conflict of interest, in that there was a special silver committee given certain authority going back to late last year, where I believe all the participants—it was very clear that they had no potential conflict of interest.

Mr. RICHMOND. Can we all agree, that the rules of the New York Stock Exchange are probably tighter than the rules of Comex or the Chicago Board of Trade as they relate to conflict of interest and trading for one's self at the same time that you are trading for

a client? Isn't it a fact that in the commodity business we don't even time stamp our trades? I could go on and on, there are so many potential areas of conflict of interest that really should be cleaned up.

Mr. SPIELMAN. I am not intimate with New York Stock Exchange rules.

Mr. RICHMOND. I am sure Mr. Johnston is.

Mr. JOHNSTON. I would say that the conflicts of interest in the commodity area aren't as great as what you think. I believe that there are rules and regulations concerning how trading is to be done for one's personal account as opposed to the handling of orders for others. The rules——

Mr. RICHMOND. However, as you know, nothing is time stamped.

Mr. JOHNSTON. Nothing is time stamped but you can reconstruct most orders going through, all orders going through our system are time stamped all the way through. There is very little problem in reconstructing orders.

Mr. RICHMOND. Except on the floor of the exchange where it would be impossible to reconstruct orders.

Mr. JOHNSTON. That is true, on the floors of the exchanges there are floor committees who keep an eye on trading.

Mr. RICHMOND. Mr. Johnston, you have been on exchange floors many, many times. You know that no human being could possibly keep an eye on all the activity on the floor. You know how confusing a trading floor is.

Mr. JOHNSTON. That is true.

Mr. RICHMOND. Certainly if we had time stamped it would help matters considerably. Each trade would then show for whom the trader was trading.

Mr. JOHNSTON. I believe every commission house would love to see a time stamp on every order if it would not interfere with the market. I don't think there is a commission house that would not want that. But I don't think there is a commission house who can see the possibility that you would have time stamping of orders on the floor without interfering with the marketplace itself, in effect almost destroying the market.

I probably handle as much business as any individual around for customers. I place orders on floors of all exchanges all over the world almost every day. I am basically happy with the treatment, with the execution of the orders on the floors of the exchange and my orders go in the same as everybody else's.

Mr. RICHMOND. Do you personally feel it is reasonable to expect one person to be a member of the board of an exchange, a trader for himself and for other investors, the person who sets margins, as well as the person who handles the financing? Do you think this a reasonable situation? Do you think this committee should allow this to continue?

Mr. JOHNSTON. Where such a person's livelihood and future and everything else depends upon the growth and the viability of the futures markets, I think that is an overriding consideration.

Mr. RICHMOND. Mr. Chairman, my time is up. I hope to have an opportunity to discuss this a little further later on. Thank you.

Mr. JONES of Tennessee. Thank you.

The chairman now recognizes Mr. Glickman for 5 minutes.

Mr. GLICKMAN. I am sorry I missed some of the testimony. Mr. Horn, I would like to ask you a few questions.

Could you tell the committee the relationship between your firm and the Hunts?

Mr. HORN. The Hunts were clients of Bache for some 13 years. We handled three brothers and the Hunt mineral account.

Mr. GLICKMAN. Are the Hunts stockholders of Bache, Halsey, Stuart?

Mr. HORN. Yes.

Mr. GLICKMAN. To what amounts?

Mr. HORN. I am not sure. I don't know how much stock they own in Bache.

Mr. GLICKMAN. My information says it is approximately 7 percent. Is that fair?

Mr. HORN. It could be. I have negotiated with securities.

Mr. GLICKMAN. What is your position with the company?

Mr. HORN. I am in charge of the commodity division.

Mr. GLICKMAN. So the 7 percent figure that I just mentioned you just accept; you don't know independently?

Mr. HORN. I don't accept it; I don't know exactly how much stock they do have. I know they own stock in Bache as many thousands of other people.

Mr. GLICKMAN. But they own a large amount of stock in Bache; you knew that or somebody knew that.

Mr. HORN. Yes, I presume.

Mr. GLICKMAN. How long have they been customers of Bache in the purchase of silver?

Mr. HORN. Thirteen years.

Mr. GLICKMAN. How long have they been stockholders?

Mr. HORN. I am not sure.

Mr. GLICKMAN. Was it a governing factor in the decision to extend credit to the Hunts the fact that they were large stockholders of your brokerage firm?

Mr. HORN. No.

Mr. GLICKMAN. Do you extend credit in the same fashion as you did to the Hunts to other commodities customers?

Mr. HORN. At times, yes.

Mr. GLICKMAN. In the same scope in terms of the amounts involved?

Mr. HORN. No.

Mr. GLICKMAN. How much credit did you extend the Hunts in the time period that we have been talking about today?

Mr. HORN. I think they had extended it somewhere in the neighborhood of about \$233 million loan against \$400 million collateral.

Mr. GLICKMAN. How does that compare with the credit you have extended with other single customers?

Mr. HORN. Others are much smaller.

Mr. GLICKMAN. Now, is it my understanding that your firm called upon the Federal Reserve Board and the CFTC to close the silver market; is that correct?

Mr. HORN. That is correct. I indicated that in my statement.

Mr. GLICKMAN. Was the fact that the Hunts were stockholders of your company and the fact that you had extended such large credit

to them part of the rationale that you did that—made that request?

Mr. HORN. No.

Mr. GLICKMAN. Why did you make the request?

Mr. HORN. Very simply as I indicated in my statement, we felt the liquidity of the silver market had diminished to a point where it was difficult to liquidate a position of any size. We felt the most prudent course was to close the exchange and settle the contracts.

However, as I also indicated in my statement, the CFTC didn't see fit to do so and the market forces took care of it; so, consequently, my conclusion was that CFTC's action was correct and the normal market process that has been taking place for the past 120 years continued to work very effectively.

Mr. GLICKMAN. Following up a little bit what Mr. Richmond asked about the question of conflict of interest, I am concerned what we have here is a situation where the public is concerned about the relationships between, in this case, the Hunts and your firm, but generally involving the commodities firms.

Last June we held hearings or a few months ago. I asked a question of the exchanges at that time what kind of effort they were making toward the development of self-regulatory regulations that were comparable to the NASD in the securities field.

I wonder if any of you have any comments on that? It would seem to me that the best place you could get a handle on the conflict-of-interest situation is through an effective, forceful self-regulatory system so you don't have to be worried about the Government enacting more stringent rules than you would like to see.

Have any of you participated in that kind of development of self-regulatory system?

Mr. JOHNSTON. I am on the board of the National Futures Association, which is a would-be self-regulatory organization under title III. Attorneys for the organization are working at the present time on a complete charter, set of rules, bylaws, and everything with the purpose of making application to the CFTC for approval as a title III organization.

Mr. GLICKMAN. I would just personally strongly suggest that you proceed with that as a way to give some confidence to the CFTC and to the Congress and to the public in the same way that securities dealers, I think over the years have developed that kind of credibility, because as I understand it, NASD really assumes as much enforcement authority as the Securities and Exchange Commission does over securities firms.

I really believe that that is something that should not be downplayed and stalled. I assume what you are telling me today is that members of the industry want to pursue that very vigorously.

Mr. JOHNSTON. Yes, sir; particularly me.

Mr. GLICKMAN. Anybody else have any comments on that question of self-regulation? By your nods, I assume you agree that we should pursue that?

Mr. GOLDSCHMIDT. I definitely agree with your viewpoint.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

The chair now recognizes Mr. Coleman for 5 minutes.

Mr. COLEMAN. Mr. Horn, I wonder if you could tell us, because and as a result of the experience your firm has had recently in the silver market, have you made any special procedural changes?

If so, would you tell us what those are?

Mr. HORN. No; we haven't made any procedural changes from what we had been doing for a number of years. We are currently looking at all of our various policies to see how effective they are and perhaps somewhere down the road we may change some of them but as yet we have not.

Mr. COLEMAN. You have had no direction from the board of directors of your corporation to immediately proceed to make any changes? I gather from your response, it is just kind of nothing priority.

Mr. HORN. I didn't say it was a nothing priority, I said—

Mr. COLEMAN. Do you have a deadline?

Mr. HORN. No.

Mr. COLEMAN. What would you suggest should be some of the changes?

Mr. HORN. Until we finish our review I have no idea. That is why we are reviewing them. We have many different policies within the firm, affect many different types of businesses, many different clients, we want to look at everything in a total package rather than going piecemeal so that one doesn't interrupt something someplace else.

Mr. COLEMAN. Your statement says you are in charge of the commodities business for Europe.

Mr. HORN. That is correct.

Mr. COLEMAN. And you have no recommendations to make?

Mr. HORN. Not at this time.

Mr. COLEMAN. All right.

Mr. Stone said this morning that the most commonly examined threat from the silver collapse has been the danger to financial institutions during the last week of March. Specifically somebody mentioned your company.

Do you feel your company was threatened with collapse?

Mr. HORN. At no time were we with any threat of collapsing, we always met all of our financial obligations with the stock exchange, with the SEC, with the CFTC.

Mr. COLEMAN. Do you know of any financial institution in the world that was threatened with collapse?

Mr. HORN. No.

Mr. COLEMAN. So you wouldn't agree with Mr. Stone's statement?

Mr. HORN. That is right, I wouldn't.

Mr. COLEMAN. Would anybody at the table agree with Mr. Stone's statement? I would like the record to show there has been no affirmative nods or any other response.

Mr. Clagett, in your statement you mentioned, you quoted, in fact, Dr. Paul, who said that margin deposits were means of restricting credit in inflationary times.

I wonder what your view would be if through another mechanism, say through the Federal Reserve regulations, that availability of credit for speculative purposes, there might be a place for limiting that? Outside the framework of the system.

Mr. CLAGETT. I would hope that it not be done.

Mr. COLEMAN. That it would not be done under any circumstance?

Mr. CLAGETT. I would hope that the establishment of margins on commodity futures contracts be left to the individual exchanges.

Mr. COLEMAN. All right. I understand that. My other question is: What about rules or regulations, some sort of limitations by the Federal Reserve so that there wouldn't be commercial lending for speculation purposes or make it tough to do so, outside the exchange, outside the entire framework of this area?

Mr. CLAGETT. Actually, as the situation stands now and based on the historical record of great success, I think, handling large markets, large volume, large open interest, so on, we have had no major losses in the markets. So I would like to let the situation, the system stand as it is.

Mr. COLEMAN. So you wouldn't support any move anywhere to try to tighten credit on people who want to borrow purely for speculative purposes?

Mr. CLAGETT. Not unless I saw a study which would indicate that it is desirable.

Mr. COLEMAN. Thank you, Mr. Chairman.

I yield back the balance of my time.

Mr. JONES OF TENNESSEE. of Tennessee. Thank you very much, Mr. Coleman.

Mr. Baldus, I yield 5 minutes to you for questions.

Mr. BALDUS. Thank you, Mr. Chairman.

I perceived an attitude here that I think I can correctly characterize that it is none of your business, you kind of run your own shop and your own exchange and that is the way you want to keep it.

On the other hand, I think it is the responsibility of this committee to oversee the exchange. And if we have commodities futures trading, they have some responsibilities and it is an ongoing thing.

I think most of you would agree that if the stock exchange hadn't taken certain steps at certain times that probably it wouldn't be in as good a shape as it is today.

I would like to pursue the one question on self-regulation that Mr. Glickman was pursuing. We didn't get to that point. Would you require a license—I understand traders are not required to be licensed now. Is that correct?

Mr. JOHNSTON. Traders?

Mr. BALDUS. Yes.

Mr. JOHNSTON. The purpose of the National Futures Association, which would be a title III organization, would be to regulate futures commission merchants and associated persons working for futures commission merchants.

It would have nothing to do with floor brokers, contract details, or things like that. This would be an organization which would regulate the activities of the Futures Commission merchants with the public.

Mr. BALDUS. Would that person be licensed then?

Mr. JOHNSTON. The people would have to be registered, yes, and there probably would be some sort of—well, there would be registration as there is now.

Mr. BALDUS. And who would regulate whether or not that person remained registered?

Mr. JOHNSTON. Well, hopefully the registration would then be with the title III organization and right now, in order to become an associated person, you have to pass certain qualifying examinations.

Mr. BALDUS. If a person violates the rules of conduct and ethics, how is that dealt with currently?

Mr. JOHNSTON. At the present time?

Mr. BALDUS. Yes.

Mr. JOHNSTON. The chances are that the firm who hires the person would take the disciplinary action.

Mr. BALDUS. Is there any requirement that that firm do that, because we have some firms that are not doing so.

Mr. JOHNSTON. In the event that this came to the attention of an exchange or was as a result of a complaint to the exchange, the exchange would see that disciplinary action is taken.

Mr. BALDUS. It is not very well defined right now though?

Mr. JOHNSTON. No; most of the disciplinary procedures, actions, are taken by the individual firms. Most of the brokerage firms are responsible and follow their employees reasonably closely.

Mr. BALDUS. It may be consistent with what another firm does or it may not. It doesn't have any set of rules or pattern.

Mr. JOHNSTON. There is no such thing at the present time as a code of ethics within the industry; one that is down in writing which applies to everybody.

Mr. BALDUS. It is getting to be a very large industry and growing rapidly and I guess you can understand our interest in that.

I would think that the committee will be quite interested in your progress on that and I wouldn't be surprised but what, if there isn't progress, the committee would be interested in setting up something, some system for you.

Mr. JOHNSTON. It is my hope that if the national futures organization comes into being, that this would be one of the things that they would do for the industry as a whole.

Mr. BALDUS. I think that is the best way to do it. I hope it occurs soon. Each of you may choose to answer this.

What is your policy or under what constraints can you undertake lending to futures customers on collateral which is deliverable on futures contracts?

Mr. Spielman?

Mr. SPIELMAN. As part of our conduct of doing business, within certain policies and guidelines; yes. We will occasionally extend credit where, among other things, we deem the collateral to be appropriate, where we deem that the customer is in a responsible financial position.

Mr. BALDUS. Company policy or case by case?

Mr. SPIELMAN. Well, it is company policy within the framework of all regulatory policies as well. It only represents in effect a small part of our total activities.

Mr. BALDUS. Mr. Goldschmidt.

Mr. GOLDSCHMIDT. We take the attitude we are not a bank, and we typically do not advance or loan money to our clients. We do on occasion, however, if sometimes it becomes necessary, a small time

for a short period to advance the money we have a fixed amount to set aside as our policy that we can use for that purpose.

Mr. BALDUS. Mr. Maringer.

Mr. MARINGER. This is not a general policy of our firm. The parent company is a commodity merchant, international merchant, and it does on occasion extend loans to clients of good standing, well collateralized, particularly collateral which we recognize and we understand, but it is usually for short periods of time. As Mr. Goldschmidt says, we are not bankers. We are merchants, at least the parent company is.

Mr. BALDUS. Mr. Clagett.

Mr. CLAGETT. I am not associated with any individual firm.

Mr. BALDUS. Mr. Johnston.

Mr. JOHNSTON. Where a client who is involved in the commodity markets takes delivery on a position for one reason or another, we usually will help finance the delivery.

Other than that, it would be unusual for a client to come to us and ask us and put up warehouse receipts of a particular commodity, and ask us to finance.

Those requests are relatively few, but on occasion they do come, and if the client—if the purpose looks OK and the client is substantial, and this seems to fit with what he does normally, then we would probably consider it, and we have done it on occasion.

Mr. BALDUS. Mr. Horn?

Mr. HORN. We do a small amount of financing of deliveries for customers as they take delivery and want financing, but it is a very, very small percentage of our overall business.

Mr. BALDUS. There is nothing unusual in recent tradings in precious metals, Mr. Horn?

Mr. HORN. Other than the fact, you know, of loans of a fairly large amount of money to the Hunts.

Mr. BALDUS. Fairly large?

Mr. HORN. Yes.

Mr. BALDUS. Thank you. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Baldus.

Now a member of the full Agriculture Committee, not a member of the subcommittee, has been a member of the subcommittee, Mr. Fithian. We are glad you are here and you take your 5 minutes now.

Mr. FITHIAN. Thank you very much, Mr. Chairman. I have four specific questions. I think we will get the position of the trade. I want clarification from testimony in the statements.

Mr. Goldschmidt, on page 9 you say, "Like all markets do, it moved to excess. It corrected itself, but again to excess," and again this is the sentence that I am interested in.

The price movement was unacceptably severe. However, sufficient regulatory authority does exist with the exchanges to prevent abuse with ample oversight authority by the CFTC.

Are you saying then that either the exchanges or the CFTC did not, in the case of the Hunts in the silver situation, act expeditiously? Is that the inference I should draw from this?

Mr. GOLDSCHMIDT. I think it is; yes.

Mr. FITHIAN. Thank you.

The second question is for Mr. Spielman of Merrill Lynch. At the bottom of page 4 you indicate, "We"—speaking for Merrill Lynch—"do not believe this additional authority is needed," and that is the position taken throughout the day.

On down a bit you say "For example, it may" speaking of the CFTC, "impose position limits on futures contracts where necessary," and then comes the sentence that I am interested in.

The Commission also has a broad regulatory authority to act where it believes a market emergency exists. None of those tools was used during the recent events in the futures market, and so we do not see a need for additional regulatory powers when existing ones.

That is existing regulatory powers "have not been shown to have been inadequate."

In other words, these tools were not used so we don't know whether they are adequate or inadequate. I am wondering if you are implying there that you think they should have been; that is, that the tools should have been, where you say, "The Commission has broad regulatory authority to act where it believes a market emergency exists."

Had you been a member of the CFTC, had you been a Commissioner, would you have acted? Would you have defined this as an emergency in the market?

Mr. SPIELMAN. If I had been a CFTC Commissioner, seeing what the exchanges, the action that the exchanges had taken, I don't think that I would have done anything different or anything more.

Mr. FITHIAN. You would not have defined this as a market emergency then? I never thought I could stump Merrill Lynch.

Mr. SPIELMAN. I don't know whether I would have defined it as a market emergency. I think that if I was a Commissioner, having all the facts in hand, I think that I might have acted had not the exchanges taken the action that they had taken.

Mr. FITHIAN. I take it Mr. Horn would disagree with you sharply, since he asked that the trading in silver be suspended. I presume that would only be asked for in the case of what somebody defined as a market emergency.

I am tempted to ask you what a market emergency would be, but I think I will forgo that temptation.

Mr. Johnston, on page 6 of your testimony you say:

On the other hand, margins at times must be high enough to restrict speculative activity when such activity tends to exceed normal levels or could create a dangerous market situation.

Was this activity high enough, or was this not considered in your judgment a speculative experience?

I am curious to know how we apply your statement to the particular event.

Mr. JOHNSTON. You are referring to silver?

Mr. FITHIAN. Yes.

Mr. JOHNSTON. Both the Chicago Board of Trade and Comex raised margin requirements substantially to discourage additional speculation because they saw the size of the positions.

Mr. FITHIAN. My question really wasn't as clear as it should have been. I apologize.

Do you think they acted soon enough in this to prevent this rather wide swing of the market?

Mr. JOHNSTON. With regard to margins?

Mr. FITHIAN. Yes.

Mr. JOHNSTON. Yes. As a general rule, margins do not, margin changes do not have a great effect on existing positions. They tend to have an effect on dampening new positions rather than—

Mr. FITHIAN. Thank you. I get the point. One last question for Mr. Horn.

At the bottom of page 4 of your testimony you say—you have just sketched out where it went from \$10.80 an ounce down from \$20. You said, "We did not believe the market had any liquidity left. The only solution was to close it."

We have already heard of that.

"As it turned out, there was a substantial liquidity of prices" and so on.

"The only solution was to close it" is the phrase I am interested in. Aren't you really saying the only solution was to close it or somebody, that is, Hunts, would be hurt in this and that Bache had much at stake?

Isn't this really what happened, and isn't that really the way that should read?

Mr. HORN. No, not really. It reads exactly the way it should read as far as my judgment is concerned. I could say if a market becomes illiquid and one cannot liquidate a position whether it be Hunts or somebody—

Mr. FITHIAN. One quick followup question. At what price did the Hunts start accumulating significant amounts of silver?

Mr. HORN. \$4, \$5. They bought nothing over—

Mr. FITHIAN. It started at \$4, went up to \$20 and it came back to \$10.80, and at that point you asked the Federal Reserve Board, which is a bit unusual to ask them to intervene, use their influence with CFTC and you asked CFTC to intervene.

I take it that that is extraordinary action on the part of any company, and I take it that you are doing this because the declining market was putting a great deal of pressure on your client, and therefore, because of your rather substantial loan, a great deal of pressure on your company.

I am not faulting you for that, but isn't it really true that you took that action because Hunt was about to be hurt very badly; that it descended down to \$10.80 and it could go all the way back down to where they got in at \$4.

Mr. HORN. Simply in our firm's judgment liquidity of the market had declined to a point where it would not have reasonably been likely that a relatively large position would have been able to be liquidated.

Mr. FITHIAN. Thank you. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Fithian.

There are a few more questions I think yet to be asked, and the Chair will ask one question that will apply to all of you except Mr. Clagett, and I would like to do this in view of the fact that the Hunts are going to be here next week on May 29 for testimony.

I would like to get this clear now.

Starting with Mr. Spielman and going right on down to Mr. Horn, my question is, do the Hunts owe you any money for any reason at the present time?

Mr. SPIELMAN. All of the accounts that we have with the Hunts are in satisfactory condition.

Mr. JONES of Tennessee. Are you saying by "satisfactory condition" if they were all liquidated today there would be no problem; that they wouldn't owe you and you wouldn't owe them?

Mr. SPIELMAN. I am going to hate to beg off the question, but I think I will have to reply by saying that I have not been intimately involved. I have not serviced the Hunt accounts. I am not intimately involved with the status of their accounts. I have been advised that they are in satisfactory condition.

Mr. JONES of Tennessee. But they do owe you some money today?

Mr. SPIELMAN. I believe there are some loans outstanding with there being sufficient collateral.

Mr. JONES of Tennessee. Mr. Goldschmidt.

Mr. GOLDSCHMIDT. The answer is "No."

Mr. JONES of Tennessee. They owe you no money today?

Mr. GOLDSCHMIDT. That is correct.

Mr. MARINGER. In fact the parent company is involved with the Hunts as opposed to myself as representative of the futures side.

I know that the parent company has had loans with the Hunts. I am not intimately familiar with them. However, I do know that they were fully and substantially collateralized, and they were all satisfactory.

Mr. JONES of Tennessee. I gather by that that they do owe you some money today then, but if they were liquidated, why everything would be in good shape.

Mr. MARINGER. That is absolutely correct, I would suspect.

Mr. JONES of Tennessee. And when I refer to the company that you represent, I am also referring to any other parent company or anyone else connected with you.

Mr. Johnston.

Mr. JOHNSTON. All I can say is not to my knowledge.

Mr. JONES of Tennessee. Mr. Horn?

Mr. HORN. There are no loans outstanding to the Hunts. They have repaid all the loans outstanding to Bache. We in turn have repaid all the loans outstanding to the banks. There are no loans outstanding involving the Hunts any place as far as we are concerned.

Mr. JONES of Tennessee. Mr. Glickman has questions.

Mr. GLICKMAN. Mr. Horn, in your statement on page 3 you speak that:

When the Chicago Board of Trade proposed regulations imposing retroactive position limits in silver future contracts in December of 1979, we expressed our strong opposition to such limits to the CFTC, nevertheless the CFTC approved the proposed limits and allowed them to be imposed retroactively.

In Mr. Johnston's statement he indicates that he doesn't think anything needs to be done; that the CFTC should also make certain that exchanges have procedures for setting and reviewing margins in line with price volatility.

I would like to ask two questions of both you gentlemen. Mr. Horn, do you not believe that the CFTC exercised appropriate legislative responsibility by approving these retroactive limits and, No. 2, why do you believe that the Chicago Board of Trade acted

improperly in imposing retroactive position limits, and why do you think they did that?

Mr. HORN. Well, very simply I say that we had requested or opposed the move by the Board of Trade. We had opposed hearings with the CFTC. Very simply, we did not believe at that time, we do not believe at this time, and I don't think we will ever believe in the future that once you start playing a game, that the rules should be changed, which I think Walter Goldschmidt alluded to in his earlier statements.

I think it is grossly unfair to all participants who are functioning and participating in a market based on a certain given set of guidelines and rules to all of a sudden change the rules in the middle of the whole thing.

That is why we opposed it. We did not oppose particularly at that time the fact that there should be position limits as far as applying them to new participants and new positions coming into the market. It was just the retroactive feature of it that we didn't—.

Mr. GLICKMAN. Your stockholders, Mr. Bunker Hunt and Mr. Herbert Hunt, testified that they felt perhaps there was some ulterior or negative motive on the part of the exchanges for imposing the limits, and also the other margin actions taken to protect others, and they weren't specific in their allegations.

I wonder if you have any comment on that. This was at the Rosenthal hearings, and I hope I am stating it correctly.

Mr. HORN. I wasn't at the Rosenthal hearings. I heard those comments. That might be their view.

Mr. GLICKMAN. Is it your view?

Mr. HORN. No.

Mr. GLICKMAN. Do you believe the exchanges acted in good faith?

Mr. HORN. I believe so, yes, and one thing which has not been brought out that my counterpart didn't mention particularly in reference to the Congressman's question over here about the conflicts of interest on the exchange.

Obviously when you have any group of individuals who are participating on a given board, there could obviously be conflicts of interest. You could have conflicts of interest within the Congress.

Mr. GLICKMAN. Never.

Mr. HORN. As we have seen at times throughout the decade. However, there is nobody in the world that is better qualified than the gentleman who did sit on the board to do it. In addition, the board, which I have sat on, Comex, which I have sat on in years gone by and have been vice chairman in years gone by, the mix on the board is so different that it is very difficult to have a conflict of interest.

Basically it is a 24-man board with a certain number made up of your people, a certain number from commission houses, from the trade, outside directors, so you have got a pretty good broad representation there.

I think that to a large degree prevents any conflicts of interest.

Mr. GLICKMAN. Do you think—the last question for anybody here—that you, as a regulated person—how do you judge the CFTC's ability to make certain that the exchanges and your firms are in proper compliance with the law, and are protecting the public interest? Give me your views of how you think the CFTC is

doing because you all pretty much say let them have it. Let them do what they are doing. We don't want any additional legislative authority so I want to know how you think they are doing.

Mr. HORN. That is a very broad question and obviously the best I can do is give you a broad answer.

I am generally satisfied with the type of regulation that the CFTC has implemented during its past 4 or 5 years that it has been in existence, has been reconstructed. We obviously don't necessarily agree on each and every item, but I think that they have done a reasonably good job.

What constitutes a good job, naturally when you have got any regulatory agency that is a newborn agency, with a lot of individuals who are on a learning curve, there are a lot of things they or their staff members come forth with which—well-meaning—think that this is going to be good or helpful to correct a certain situation when in fact the premise upon which they have conceived the idea may be totally incorrect.

I think that they have been reasonable men in the sense that in most instances we have been able to sit down, and where there has been gross inadequacies and gross errors in the type of things that they have been doing, show them that there has been such errors. I think they have basically done a good job. I think the industry has grown and thrived, and I don't think they need any further changes.

One other reference that I would like to make before I turn it over to my associates in reference to this Congressman's remarks over here. You sort of mentioned before, which I didn't want to leave it on the table, that there is some kind of adversary relationship between you people and us. That is certainly not the feeling or attitude on our part.

If it is, I think I can speak for all these gentlemen that it is a misconception. I mean we have come down here to Washington at your invitation and have tried to answer whatever questions you have put forth.

If there is anything that should be changed, we would certainly welcome or entertain the proposition. I don't want you to walk away with the feeling that it is a "you against us" type of thing.

I think we all stand to gain or lose together.

Mr. GLICKMAN. Does anybody else have any comments on that question? I would just say in light of what you have said, we certainly don't want to create an adversarial relationship. Through the good auspices of our chairman, who has served with the incentive to hold these hearings, we are just trying to determine whether there needs to be any legislative changes or not. We want to do the appropriate oversight.

This is the committee of authorizing jurisdiction. CFTC spends a lot of money and what is more billions and billions of dollars are traded every year in commodity futures, and so we would hope that you understand why we want to do this kind of oversight.

Mr. JONES of Tennessee. Mr. Baldus.

Mr. BALDUS. I would like to ask this question of each of you: What has been your firm's recent experience with forced liquidations in futures trading; that is, customers' positions sold out because they didn't meet margin calls, and I would be particularly

interested to know in precious metals and in other commodities if there was a ripple recently or a wave or a tidal wave of forced liquidations.

Mr. SPIELMAN. No, I know of no wave of forced liquidation. I am sure there has been an occasional sellout, but nothing of any significance.

Mr. BALDUS. Mr. Goldschmidt?

Mr. GOLDSCHMIDT. I think maybe calling it a wave might be misconstruing it, but I do think that the volatility of the marketplace has been such that there have been probably more of them in the last 2 or 3 months than maybe in a similar 2- or 3-month period.

Mr. BALDUS. Any way you should characterize those customers who sold out? Were they new people who had gotten into the market that didn't have sufficient resources to hold on?

Mr. GOLDSCHMIDT. It is difficult to characterize. Everyone has their own particular reason for it, but you know, when you have got price swings as volatile, I think we had a few more than usual. There is nothing that I am aware of, of any kind of a pattern.

Mr. BALDUS. Mr. Maringer.

Mr. MARINGER. I am not aware of any wave of liquidation. As Mr. Goldschmidt said, the markets have been very volatile, and there must be probably more liquidation than in normal times, but I cannot perceive of any wave of liquidations.

Mr. BALDUS. Mr. Johnston.

Mr. JOHNSTON. I think that the market activity has forced individual speculators to liquidate positions to keep their accounts straight. We have not had any unusual amount of liquidations which we as a firm force on customers.

Mr. BALDUS. Mr. Horn.

Mr. HORN. We have not had any ripple effects or anything above and beyond the normal amount of liquidation.

Mr. BALDUS. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Baldus. Any other questions?

I would like to, before we adjourn, follow up on just what Mr. Glickman said a moment ago.

I want to argue, gentlemen, to please understand that this subcommittee has no ulterior motive in having you gentlemen here, having this hearing, or for any other purpose.

Somebody alluded to the fact that the CFTC had gone through a learning process or was going through one to some degree. It is possible that this subcommittee has also been going through some learning processes as well in view of the fact that not nearly all of our time is spent here with commodities. We have many other fields to cover also.

We do appreciate though very much your being here. Some of you, I believe, Mr. Goldschmidt, has not been before any of the committees here on the Hill, at least this session of Congress, and maybe some of the others have not either. We appreciate your interest in coming to our hearing, and I assure all of you that we are here for one purpose only and that is to make your industry a better industry if we possibly can, and we do want to cooperate to the extent that we can, and that is the purpose of calling this

hearing, to determine whether or not we do need additional oversight and additional legislation.

Thank you again, and all of you who were here this morning.

The meeting stands adjourned until 10 o'clock tomorrow morning.

[Whereupon, at 4 p.m., the subcommittee was adjourned, to reconvene at 10 a.m., the following day, Thursday, May 22, 1980.]

[The prepared statements referred to previously follow:]

PREPARED STATEMENT OF READ P. DUNN, JR., COMMISSIONER,
COMMODITY FUTURES TRADING COMMISSION

The Commodity Futures Trading Commission has provided to the Subcommittee a detailed report describing activities in the silver futures markets which occurred predominantly from August 1979 through March 1980. This report should provide members of the Subcommittee with a better understanding of the various market conditions which existed during this period as well as the actions taken by the Commission and the commodity exchanges in response to those conditions. I will not attempt to recount all of those facts here today. Nevertheless, I believe it would be helpful to outline certain aspects of the silver situation for this Subcommittee.

Silver futures trading first became subject to federal regulation in 1975 as a result of Congress' enactment of the Commodity Futures Trading Commission Act of 1974. Since 1975, the Commission has exercised oversight of trading in silver futures on the Commodity Exchange, Inc. ("COMEX") and the Board of Trade of the City of Chicago ("CBOT") where the vast majority of silver futures contracts are traded. In addition, the Commission receives daily reports on the positions of participants in silver futures trading who hold 250 contracts (the equivalent of 1,250,000 troy ounces) or more in any future.

Through its surveillance program, since 1975, the Commission has been informed of silver trading activity by members of the Hunt family and entities in which the Hunt family has a financial interest. From the middle of 1975 through July 1979 the net silver positions of all Hunt-related accounts on COMEX ranged from 1% to 6% of the open interest.

The Hunts generally did not make or take delivery of silver on these futures contracts. Rather, after 1976 they liquidated their existing positions and re-established or "rolled over" their silver positions in distant months.

In early 1979 the Commission became aware that the Hunts were increasing their long silver futures positions. In July 1979, a corporate account for International Metals Investment Corporation ("IMIC"), which the Commission learned was Hunt-related, also began establishing long futures positions on both the COMEX and CBOT. In addition, during the first half of 1979 substantial new long positions in silver were being established in accounts carried at ContiCommodity Services ("Conti") a futures commission merchant. Most of these positions were for foreign accounts, principally in the COMEX December 1979 future.

By the end of July 1979, silver futures were trading between \$9 and \$10 an ounce. Cash silver was similarly priced. However, beginning in August, the price of silver began a steady upward climb, as did the price of other precious metals.

At this time, neither the Hunt net positions nor the Conti net positions comprised more than one-fifth of the total open interest in silver futures. Nevertheless, the Commission was concerned about the large size of these positions and in early September 1979 the Commission directed its staff to communicate with the COMEX, CBOT, clearing members of the exchanges and certain traders in order to inform them of the Commission's concern that all parties carry out their responsibilities for ensuring the integrity of the market. During September the COMEX and CBOT exercised their emergency powers to impose new requirements for trading in silver and also increased margins.

In early September the Commission also issued a special call to determine for whose benefit some of the positions carried in foreign accounts through Conti were held. The Commission also authorized a special call to IMIC which recently had established substantial long positions. The Commission later learned that the Hunts held stock in IMIC and that W.H. Hunt is a director of IMIC and participated in IMIC's trading decisions.

At this time (September), the primary focus of the Commission's surveillance concern was on the December 1979 COMEX future since no substantial concentrations of positions existed in the futures which matured in earlier months. The price of the maturing silver futures contract rose from approximately \$12 in early September to approximately \$16 at the end of October. In late September and early October, the Commission determined that IMIC and a few of the Conti accounts intended to accept delivery on their long futures positions. These acquisitions of physical silver increased the Commission's concern. This concern was expressed by certain members of the Commission at a public Commission meeting on October 16, 1979. Subsequently, both the COMEX and the CBOT took further emergency regulatory actions. The CBOT imposed a 600 contract net position limit on silver futures holdings. The COMEX increased its original margin requirements from \$20,000 to \$50,000 for all contracts other than bona fide hedge transactions.

In response to a Commission special request for information, the Hunts reported to the Commission that at the end of October 1979 the Hunts and IMIC, combined, owned approximately 26% of COMEX silver stocks and 62% of CBOT stocks for a total ownership of 56.3 million ounces of certificated silver. In addition, IMIC owned approximately 28 million ounces of non-certificated silver.

In mid-November, the Commission was concerned about a potential squeeze of the December COMEX future. However, by the latter part of November, a substantial portion of the major long positions in that future were liquidated. In addition, the Commission's staff surveyed the shorts and learned that the shorts had sufficient certificated silver and intended to make their required deliveries on the contract. These two factors operated to alleviate the threat of a squeeze in the December future.

The Commission then concentrated its attention on the February 1980 CBOT contract and the March 1980 COMEX contract. By this time, the Hunts had assured both the Commission and the exchanges that they intended to liquidate most of their long positions prior to the delivery month.

The price of silver nearly doubled during the month of December. As the price increase began, the CBOT responded by increasing margin and by requiring clearing member firms to file daily reports concerning silver futures positions. The Commission was concerned that the cash and futures positions of the Hunts, IMIC and the Conti group were becoming too large relative to the size of U.S. and world markets. The Commission noted that futures markets were not intended or designed to be substitutes for cash markets for the acquisition of a commodity and that the futures market, and perhaps even the world cash market, might no longer be capable of supplying the large quantities of physical silver then being demanded. Therefore, the Commission decided that some additional action had to be taken as soon as possible. Accordingly, the Commission instructed the Executive Director to arrange a meeting with the senior officers of the exchanges on which silver futures were being traded. That meeting was scheduled for January 8, 1980.

On the evening of January 7, 1980, the COMEX adopted a temporary emergency rule which established reporting requirements and imposed a monthly gross position limit of 500 contracts for the January and

February 1980 futures, and a net position limit of 2,000 contracts for all futures combined. Following this action, silver prices declined for one day and then continued to move sharply upwards. The Hunts and other large traders continued to acquire, but not entirely through the futures markets, large quantities of silver. By January 21, the spot London silver bullion price had risen to \$49.95. On that date, the COMEX delayed the opening of its silver market until the afternoon and exercised its emergency authority to limit trading in all COMEX silver futures contracts to liquidating transactions. The next morning, the CBOT adopted an emergency rule calling for phased liquidation of nearby futures positions. In addition, on February 4, 1980, the COMEX raised margin levels to \$60,000 per contract for traders holding more than 251 contracts and to \$75,000 per contract for positions in the spot month.

Following these actions, the price of silver futures declined somewhat and by late February was trading at around \$35 per ounce. In early March, silver prices began to fall sharply again from about \$33 on March 7 to \$17 on March 17. Thereafter, prices stabilized again and traded in the range of \$20 to \$22 until March 25. Throughout this period there were only minor position changes by the longs.

The decline in silver prices culminated on March 26 and March 27. Silver prices fell from \$20.20 on March 25 to \$15.80 on March 26. At that point the \$75,000 spot month margin requirement constituted approximately 95% of the value of the contract. On that day, COMEX reduced the spot month margin to \$50,000. On March 27, however, the price continued to fall and closed at \$10.80. The Commission was asked to declare an emergency and suspend trading in silver. Fears were expressed by many that the price of silver would continue to drop resulting in severe financial damage to major

brokerage houses and banks. The Commission declined to invoke its emergency authority. The price of silver did not drop further.

Following these rapid and significant developments, the Commission began the process of assessing what had happened and why. This process continues today. The Commission's staff is conducting an inquiry into the conduct of the exchanges and various market participants. Until this inquiry is concluded, the Commission believes that it would be unwise for us to indulge in conjecture about the guilt or innocence of people or organizations. The Commission can report that it has brought an administrative proceeding against Banque Populaire Suisse—one of the major foreign accounts trading through Conti—for failure to comply with a special call issued by the Commission. Since this proceeding is presently pending before the Commission, it would also be inappropriate for the Commission to discuss the eventual outcome of this action. From a regulatory perspective, the Commission's staff is reviewing carefully the Commission's minimum financial rules, the question of position limits, and the propriety of certain trading practices in order to determine whether our regulations should be strengthened. The Commission's staff has been directed to review the propriety of imposing certain position limitations on the amount of futures positions which may be held during the delivery month. We will advise this Subcommittee of any actions we take in this regard.

At this point in time, however, there are certain observations which the Commission would like to share with the Subcommittee. The recent situation in silver was not one in which the major long traders held an unusually excessive percentage of the open interest in any future.

Even when added together, the Hunts' combined net positions, computed for month-end dates, never exceeded 13% of the open interest. In addition, when the price of silver peaked in January 1980, the Hunts' long positions were only approximately one-fourth of the positions which the Hunts had held in September 1979. Indeed, while the Hunts' positions had been reduced by three-fourths, the price of silver from September 1979 to January 1980 increased approximately by 500%. Accordingly, it would appear from the evidence available at this time that factors other than the Hunts' futures positions affected the price of silver.

In addition, there was significant commercial participation in silver trading. On COMEX, for example, at the end of the months of July and August, short hedges represented 40% of the adjusted open interest, that is the total open interest minus the spread positions. This short hedging participation grew to 48% of the adjusted open interest by the end of February 1980. The long hedgers at the end of July and August held from 16% to 21% of the open adjusted interest.

We should also point out that the exchanges continually adopted self-regulatory measures to deal with the market situation. Exchanges raised margin, imposed position limits and detailed reporting requirements. Thus, the underlying premise of the Commodity Exchange Act was evidenced by the developments in the silver markets—day-to-day futures trading activity should be subjected to meaningful self-regulatory action by the commodity exchanges and informed Commission oversight of these activities.

It is the view of the Commission, therefore, that no statutory changes need to be acted upon by this Subcommittee at this time. The Commission believes that all futures markets should continue to be regulated under the general authority and direction of the CFTC. The advice and

guidance of other federal agencies having relevant experience and expertise is important and we will continue to solicit and listen to their views. However, as is the case in all administrative responsibility, the final authority must rest in one agency. That agency should be the CFTC.

The principal purposes, objectives and provisions of the Commodity Exchange Act are sound. The Commission has been entrusted with responsibility for ensuring the integrity of the futures markets. This means assuring that the forces of supply and demand will be fairly and accurately reflected in the marketplace. In addition, the Act provides significant protections to the trading public. These customer protection features include broad prohibitions against fraud, stringent segregation requirements, and registration of those in the commodity industry who deal with the public. The Commission may initiate judicial or administrative proceedings to secure compliance with these customer protection features.

One problem which was experienced by the Commission in connection with its surveillance of the silver market concerns the availability of trading data from foreign participants in U.S. futures trading. The Commission has taken two steps to address this problem. The Commission has proposed a new rule which would require the automatic liquidation of a foreign account if a futures commission merchant was unable to obtain certain information, such as the identity of the beneficial owners of positions in the account, when the information is requested by the Commission. In addition, we have already adopted a new rule which should facilitate the service of Commission communications and complaints on foreign persons.

With respect to margins, the Commission believes that Congress wisely left the authority to set and maintain margins with the exchanges. The primary purpose of margins in the futures markets is to protect the financial integrity and assure the performance of the contracts. Margin, as used in futures trading, is not credit. It is earnest money or a security deposit. Margin levels are set to reflect the probable changes in the value of the contract so that, in the event of a customer default, a contract can be liquidated without loss to the broker. This is usually calculated by using some multiple of the most recent price fluctuations tempered by a judgment concerning possible future trends. If the equity in an account drops below the maintenance margin level, usually three-fourths under the original margin, the customer is required to pay an amount to bring the value back to the original level.

The margins are set by the clearing houses for clearing members. The exchanges may, and usually do, impose their own higher margin minimums which must be complied with by the customers of futures commission merchants. In addition, futures commission merchants can fix their own margin levels for customers but this can never be less than the exchange minimums.

Margins may be established at different levels for different members by the clearing houses depending upon their evaluation of a number of factors, including, the financial risk involved in a particular market situation and the trading status of the customer (speculator or hedgers). These are usually in the form of super margins. Margins are also set at different levels for different customers by the commission houses in consideration of the ability of the different customers to assume the risks. These margin levels are never less than exchange minimums.

When margins are set high, this is an indication that volatility is high. Conversely, when they are set low, this is an indication that volatility is low. The level of margin obviously has an indirect effect on the participation in the market, especially of speculators. Small speculators with small capital may participate more actively when margins are low and less actively when they are high.

The adjustment of margins is a matter of fact and judgment. It is necessary to have enough speculators to provide the necessary market liquidity and to assume the risk which hedgers, who are adverse to risk, wish to transfer. Rarely is there an equal number of long hedgers and short hedgers. When sudden changes occur in market conditions, it is especially necessary to have speculators available to assume the risk of hedgers. If margins are too high, speculators that might otherwise come in to assume the risk may not trade and the market will not be able to serve its intended function.

Some people discussing margins have sought to assign other functions to margin than preserving the integrity of the contract. It has been suggested that margins be used to limit market participation to keep out the little guys with limited capital. It is true that high margin levels will have an effect of this nature, but is it desirable to restrict participation and, if so, is this the best way to do it? Further analysis is required.

It has been suggested that margins be used to limit increased participation by speculators who can pyramid positions by drawing down profits or using margin equities to finance new margins for new positions, thus causing excessive speculation. But, this raises a basic principle.

Should market participation be limited by the source of the funds used for margins? Suppose a person makes a capital gain selling a house. Should he be limited from using such capital in the futures market? Then, if this rule is established, when does it apply? When does a position become excessive speculation? There should be a more direct means of limiting the size of positions.

It has been suggested that margins be used to control the flow of capital. This assumes there is a large capital flow into futures. The volume of this flow is really not large. The margins are marked to the market every night so the net flow is really zero. The only large sums that flow are the monies that are used to finance the commodities taken on delivery in fulfillment of the contract. This is usually not more than 10% of the open interest. Otherwise, the money that flows are fees which are not large. Margins cannot control much capital flow. Certainly, raising commodity margins cannot be expected to redirect the flow of capital into the equity market if the securities markets do not appear to be attractive.

In short, it is doubtful that margins can be an efficient means to achieve purposes other than insuring performance on the contract. Certainly, there are other more direct ways to limit harmful trading. Attempting to use margins for other than the intended purpose may well result in the intended purpose not being well served.

At this time, the Commission believes its legal authority is adequate. We expect to make formal recommendations on legislation during the Commission's reauthorization process in 1982.



OPENING STATEMENT OF

COMMODITY FUTURES TRADING COMMISSION CHAIRMAN

JAMES M. STONE

BEFORE THE

SUBCOMMITTEE ON CONSERVATION AND CREDIT

COMMITTEE ON AGRICULTURE

UNITED STATES HOUSE OF REPRESENTATIVES

MAY 21, 1980

Mr. Chairman and Members of the Subcommittee, I am pleased to offer my views this morning on the dramatic series of recent events in the silver market. As is appropriate in collegial deliberative bodies, the members of the Commission may hold differing opinions concerning the seriousness of the silver bubble of 1980 and what remedial action, if any, is called for to prevent a recurrence. The perspective that follows is strictly my own.

My principal conclusion from the events of the last few months is that massive, unchecked and unnecessary speculation in commodities is an unacceptable threat to our nation's tightly interwoven financial structure. Large scale speculation in commodities is not a harmless pastime. It is a form of gambling which endangers our economy. Futures markets must not be permitted to depart from their economic role in commercial facilitation and become centers of unrestrained speculation. The table appended to

this testimony plainly demonstrates the range of speculative participation. The wheat and corn markets are examples of futures markets which have remained predominantly commercial. At the Kansas City Board of Trade, the open interest in wheat is more than 80 percent hedging. The frozen pork belly market, on the contrary, is more than 80 percent speculative. The markets in Treasury securities are likewise dominated by speculators. More to the point of today's hearing, the silver market is without question a predominantly speculative market. Open interest on the two major exchanges has averaged at least 80 percent speculative in recent years.

Overwhelmingly speculative markets are of questionable value under any circumstances. Under the price leadership of a few disproportionately large traders, they are the natural birthplaces for speculative bubbles. History has taught us that bubbles burst. When they do, they all too often trigger economic chain reactions. Holland's 17th century tulip bubble, England's 18th century South Sea bubble, several attempted commodities corners in this country in the last century, and the great stock market bubble of the roaring twenties -- each preshadowed a general economic collapse. It should not have been surprising that when the silver bubble broke this March, the impact threatened to extend well beyond the commodities markets.

The most commonly examined threat from the silver collapse has been the danger to financial institutions during the last week of March. It is no secret that the Chairman of the Federal Reserve, the Deputy Secretary of the Treasury, the Chairman of the Securities and Exchange Commission and I virtually ceased all other business for three days as we monitored the potential for disastrous ripple effects throughout the economy. It was feared that the positions of the Hunt family were too large to be liquidated without triggering a round of panic selling. There was a danger that margin calls to other market participants could force additional position reductions and increase the panic. A sudden rush to raise margin funds in the silver market could have caused other markets to experience selling pressure. And, because major banks and brokers had financed the activities of the largest speculators, the effects of any silver margin defaults could have spread rapidly through the securities and banking sectors.

A professor of economics wrote as follows in describing the situation: "The crash of the silver market revealed that funds are available for large deals that violate basic canons of finance and that when these deals unravel the viability of financial markets and institutions can be endangered." I agree. We will never know how close we came to the edge of a general financial panic, but that is an issue which need not be settled. There was no economic benefit in the craze for silver to justify even a small risk of economic collapse.

The risk of collapse in the economic fabric of the nation was not the only public cost of the silver bubble. There were adverse implications, not just in risk but in fact, for employment, for inflation and for the allocation of credit.

Wide publicity has been given to how Kodak, the nation's largest producer of photographic film, was affected. For every one dollar increase in the price of silver, monthly production costs are estimated to have risen by \$4 million. The voices of smaller businesses need to be heard as well. Writing to Senator Henry Jackson, the owner of a small printing company in the State of Washington complained that the bubble "just about ruined me . . . it will take 6 to 12 months to catch up financially." Writing to Congresswoman Barbara Mikulski, a Baltimore woman tells of how her silversmith husband was laid off by his employer after thirty-two years of employment. She writes: "A silver craftsman is an American worker as much as his counterpart in the automobile industry," and complains that, while the taxpayers bail out Chrysler, "thousands of workers in the silver industry who cannot afford it are being hurt by silver speculators." I have checked her figures on employment loss. The woman from Baltimore is not exaggerating when she talks of thousands of victims. According to the Department of Labor's Bureau of Labor Statistics, 6000 jobs were lost in the jewelry, silverware and plateware manufacturing industry between November of 1979 and February of 1980.

Inflation is the number one concern of the average American consumer. The silver bubble worsened that problem as well. The Bureau of Labor Statistics reported on February 15, 1980 that "the Producer Price Index for intermediate materials, supplies and components rose a seasonally adjusted 2.8 percent from December to January, the largest monthly rise since August, 1974." The report goes on to say that "a 94.7 percent rise of prices for precious metals accounted for about one quarter of the increase in the total intermediate materials index." At the finished goods level, a 1.6 percent monthly increase was recorded; the Bureau attributes "much of the acceleration" to steep price increases for household flatware and precious metal products.

These price increases, moreover, were by no means confined to luxury items. The price of medical x-ray film, an expense shared by every economic stratum, jumped 93 percent. Phototypesetting paper used in newspaper printing rose in cost by 75 percent. The full inflationary effects of the silver bubble on consumers are hard to measure. In an indexed economy, they may be even harder to erase. Once a cost has been echoed through all of the elements of our intricate pricing system, even a decline in the primary price cannot necessarily undo the damage.

Credit availability as well has been affected by the silver bubble. The largest silver speculators held their enormous positions with the aid of hundreds of millions of dollars in borrowed money. Banks, too strapped for funds to lend for productive uses in agriculture and industry, were only too willing to finance speculation in commodities. I doubt that the Hunts were the only silver market participants to borrow money. As the price of silver was driven higher during the winter, the holders of short positions were required to put up substantial unanticipated amounts of variation margin. When the price began to plummet, the longs had to raise variation margin money in a hurry. Somehow, the resources for speculation were found while smaller loans elsewhere were being turned down in profusion. The debate over credit distortions rages even now, with the Hunts alleging that unless they can "restructure" over a billion dollars in loans additional silver will be dumped on the market.

The Hunts were not the only victims of what happened in silver. They can afford to live with inflation. They did not lose their jobs. They have not been denied credit. And, before a Senate committee, they have testified that they are not even sure whether they made or lost money on their silver speculation. The market did not take care of all the problems. The markets may indeed have eventually restored a more sensible price than prevailed in January. But the boom-and-bust of the silver bubble was far from costless. When society has seen fit to

sanction other forms of gambling, it has wisely and consistently adhered to the principle that it should be insulated from all genuine productive activity. Excessive speculation in silver provides a good example of the harm that can come when this principle of insulation is violated.

It is an unfortunate aspect of our political life that it often requires a major catastrophe to change public policy. I surely hope the lessons and punishments of 1980 prove sufficient to teach us something about the dangers of runaway speculation in commodities. A short list of corrective measures, taken together, would go far to diminish the likelihood of a recurrence of this year's bubble. I am pleased to see this Subcommittee actively studying legislation on the most important of these.

Low speculative margins are probably the single strongest inducement to widespread non-commercial use of futures markets. Traditionally, the exchanges have set speculative margins low, often a small fraction of the value of the contract. In the silver market, for example, prior to September of last year, margins were generally lower than 5 percent. Accordingly, when silver was selling at roughly \$10 an ounce, the margin required was only 30 cents an ounce. Each time the price rose another 30 cents, the value of the speculator's initial investment was doubled.

The arguments for commodity margin control are similar in some respects to those offered with respect to the stock market following the great crash of October, 1929. This is the case despite the fact that margins in the two areas are legally quite distinct. The distinctions should not be cited to obscure some important operational similarities between commodities and securities margins. One important commonality between these differing concepts of margin is that each serves as a threshold determinant for a customer considering entry to the market. The initial decision on market entry and the quantitative decision on how large a position to take may in large measure depend on the relationship between available speculative cash and the amount of margin required.

A second common element in securities and commodities margins is the potential role for margin in the acceleration of sudden market fluctuations. When margin deposits are low, price movements may generate sufficient calls for additional deposits that customer decisions about account maintenance are heavily influenced by ability to meet the calls. A market characterized by low margins is a market vulnerable to chain reaction price movements which may become self-sustaining and tend to distort fundamental price formation.

Congress has stated that excessive speculation can be a burden on valuable interstate commerce. It is thus appropriate to limit

speculative activities to a level conducive to useful commerce. There is little dispute among experts in futures markets that control of margins is among the most powerful tools for influencing market participation. Margins, established at carefully selected levels in all markets at all times, can help to maintain a proper balance between speculation and hedging activity. The need to protect markets from chain reaction price movements, moreover, is similarly met by an effective and ongoing program of minimum margin requirements. I would note, however, that margin authority granted only to cure a demonstrated irregularity will not suffice for these purposes. Once a bubble has formed, there is no tool that lances it without harmful side effects. Margin authority is better as an element of prevention than as a cure.

The second step we must take to reduce the risk of a recurrence does not require Congressional action. You have already granted the Commission authority to impose speculative position limits. Large positions are a prerequisite to many market manipulations. But, even when they are taken with the most innocent of motives, they are a threat to free markets. A position so vast that it becomes immobile can only impede valuable price discovery. A position so vast that it requires strategic decision-making on the part of the holder negates a basic assumption of competition. A position so vast that its preservation is equated with the health of the market itself or with the solvency of related institutions poses even greater dangers. There may be nothing good to say about speculative positions large enough to dominate a market.

The Commission's contrasting experiences with the wheat market in early 1979 and the silver market more recently should teach us that two kinds of limits are needed. The limits needed to prevent a squeeze in March wheat were of a different character from those which would have best restrained the Hunts. The wheat case argues for tight restrictions on all positions in the marketplace as the delivery period approaches. The Commission voted recently to ask our staff to develop for consideration a program which would establish limits of this type. The silver situation should teach us, though, that additional limits on speculation are also required. A delivery month restriction would have had no serious impact on the Hunts. The silver market needed absolute size controls on speculative positions in all months combined. Limits of this variety exist already in the grains; they ought now to be extended to all other commodities as well.

My third and final recommendation, which I understand will not be the focus this morning, concerns the behavior of credit institutions. I believe it imperative that restrictions be placed on the ability of banks and commission houses to finance their customers' speculative activities. Since the Great Depression, banks and brokers have been prohibited from lending money to meet legally set margins on securities. They regularly, however, make such loans to finance speculative margins in commodities. There is no reason for this disparity to continue. In a period of tight money and inflation, the case for such restrictions seems almost self-evident. Large volumes of speculative loans do nothing

to help the hard pressed American family nor do they help to build productive capacity for the economy. Their impact is largely to fuel a questionable economic activity and to increase the risk of the institutions extending the loans. Had banks and brokers not been endangered by the potential chain reaction last March, the public concern over silver would have been vastly diminished.

I take no pleasure in appearing before this committee as a Cassandra who warns of impending doom. But I wish to be unambiguous in my message. Unconstrained speculation in commodities may be extremely attractive to an industry which depends upon trading volume. It may be attractive for the largest of market participants, those enjoying special access to information or market dominant size. We need to look, though, with extreme care at whether it is less healthy for the small farmer, the small businessman, the consuming public or the fabric of an economy as a whole.

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

2000 K Street, N.W.
 Washington, D.C. 20581



May 19, 1980

MEMORANDUM

TO: James M. Stone
 Chairman

FROM: James A. Culver, Director *JAC*
 Division of Economics and Education

SUBJECT: Speculative Open Interest in Various Markets

Per your request attached are estimates of the percent of average monthend open interest which is speculative (including spreading) for various markets. These estimates are based on the amount of open interest which was reported to the Commission as speculative on the '03 reports and estimates of the amount of open interest held by non-reporting traders which was speculative.

Speculative positions for non-reporting traders were estimated using a statistical technique first employed for this purpose by David J. S. Rutledge, Associate Professor of Economics, Macquarie University, Sydney, Australia, while a visiting Associate Professor at Stanford University (Food Research Institute Studies, XVI, No. 3, 1977-78, pages 205-211). Coefficients for the estimating equations are based on data obtained from full market surveys conducted by the Commission and its predecessor agency, the Commodity Exchange Authority. Commodities surveyed include agricultural commodities, foreign currencies and financial instruments. The estimates for commodities which have never been surveyed are based on relationships for the surveyed commodities.

Attachment

SELECTED COMMODITIES, PERCENT OF AVERAGE
MONTHEND OPEN INTEREST ESTIMATED TO BE
SPECULATIVE AS OPPOSED TO HEDGING 1/
(FY 1979)

<u>Agricultural Commodities</u>	<u>Market</u>	<u>Speculative Including Spreading</u>	
		<u>Long</u>	<u>Short</u>
Wheat	CBT	61.1	51.1
	KCBT	26.9	14.6
Corn	CBT	42.8	29.0
Soybean Complex	CBT	60.3	43.6
Live Cattle	CME	88.3	61.7
Frozen Pork Bellies	CME	94.2	84.9
Potatoes	NYME	84.5	55.5
Coffee "C"	NYCS	82.2	47.5
Sugar #11	NYCS	73.3	37.1
Cotton	NYCE	63.2	26.4
<u>Metals and Financial Instruments</u>			
Copper	CEI	78.6	34.2
Gold	IMM	92.5	87.7
	CEI	81.3	73.1
Silver	CBT	95.9	91.0
	CEI	85.6	76.0
Canadian Dollar	IMM	89.8	58.1
Deutsche Mark	IMM	90.0	53.6
Swiss Franc	IMM	79.9	54.5
GNMC (CDR's)	CBT	65.5	60.9
U.S. T-Bills (90 Day)	IMM	83.9	77.5
U.S. T-Bonds	CBT	73.9	70.5

1/ Traders who own or control futures positions at or above certain levels specified by the Commission are required to file reports classifying these positions as hedging or speculation. Total positions classified as speculation were obtained by adding reported positions to an estimate of speculative positions which are held by non-reporting traders. These latter estimates were derived by using a method first employed for this purpose by David J.S. Rutledge, Associate Professor of Economics, Macquarie University, Sydney Australia, while a visiting Associate Professor at Stanford University. (See Food Research Institute Studies, XVI, No. 3, 1977-78, pages 205-211.)

TESTIMONY OF THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON CONSERVATION AND CREDIT
OF THE
HOUSE COMMITTEE ON AGRICULTURE

I welcome this opportunity to discuss the Treasury's role in the recent developments in the commodity futures markets as Treasury shares this committee's concerns about orderly markets.

The Treasury Department has no specific statutory authority over any market for commodities or commodities futures or any participant in those markets. As this committee is aware, the Treasury's initial concern with the rapidly developing futures markets centered on the potential impact such markets might have on Treasury's debt management flexibility and on the underlying cash market for government securities. However, the recent developments in the market for silver futures and the rapid proliferation of new futures, forwards and options contracts have raised broad issues about the stability and orderly development of these markets.

Historically Treasury has had an interest in the precious metals' markets. As the custodian of the nation's reserves of gold and the Cabinet agency responsible for international monetary policy, Treasury closely and continually monitors the markets for gold. Treasury was similarly concerned with the silver markets, but by 1970 silver had been eliminated from our new circulating coinage and most of the nation's then remaining silver reserve had been sold in the market or transferred to the General Services Administration. Treasury purchases copper for coinage and has conducted a gold auction program since May 1978, but otherwise is not directly involved in transactions relating to commodities.

In the Futures Act of 1978, the Commodity Futures Trading Commission was required to consult with Treasury prior to designation of new contract markets involving transactions in any security issued or guaranteed by the United States or

any agency thereof and with respect to certain other actions. Treasury's interest in these financial futures is clear, and the Treasury had sought a much stronger role. We recommended that the Secretary of the Treasury be given a veto authority over contract market designations. The Act as passed, however, did not give the Treasury this authority nor any role in markets relating to commodity futures, as opposed to financial futures.

Because Treasury engages in extensive monitoring of, and operations in, the foreign exchange markets, it also closely watches the markets for futures involving foreign currencies, but it has no statutory responsibility for that area.

More generally, because the Secretary of the Treasury is the chief financial officer of the government, the Treasury Department has a keen interest in the efficient operation of all financial markets. Excessive speculation in any market that adds to inflationary pressures and expectations or which might destabilize other markets is within the purview of the Secretary. And traditionally Treasury officials have monitored markets--including the commodity markets--with those concerns in mind.

In summary, the Treasury presently has no statutory responsibility, or authority, to do anything in the commodities futures markets. It is a direct participant in the gold markets and has an advisory role with respect to contracts involving future delivery of U.S. Government and Government guaranteed securities.

Next, Mr. Chairman, I will address the activities of the Department relating to silver during the six months prior to March 27. As you will recall, the gold market was subject to considerable speculative activity during 1979. In October 1979, at his initiative then Under Secretary Anthony Solomon met with representatives of the CFTC to discuss developments in the gold and, to a lesser degree, the silver markets. The World Bank and the International Monetary Fund had just concluded their annual meetings in Belgrade and representatives

of several countries had expressed concerns about the run-up of both gold and silver prices and the implications for inflation and the exchange markets. The speculative nature of trading in these markets was discussed, as well as the possible need for regulatory measures including higher margin requirements on futures contracts for silver. Treasury had no information regarding the size or value of anyone's position; nor was our assistance requested with respect to the situation.

There were numerous staff contacts with representatives of the CFTC during the fall and winter, principally concerning the markets in financial futures pursuant to the statutory responsibilities I referred to earlier. It is possible that in those meetings there also may have been some discussion of the situation in silver, but I have no personal knowledge of such contacts.

My personal involvement in the silver situation commenced on the afternoon of Wednesday, March 26, when I received a call from Chairman Volcker in which he reported that a leading brokerage house might be in difficulty because the Hunt interests were failing to meet substantial margin calls. Prior to that call, I had been generally aware of intensified speculative activity in the silver market, but I had no direct contact with either the CFTC or any other regulatory agency about this subject. In fact, in my testimony before this committee in February, I stated only that both anecdotal evidence and the volatile prices in many of the futures markets was indicative of an increased level of speculative activity and cause for concern.

In the days following March 26, I conferred frequently by telephone or in person with Chairman Volcker and the Chairmen of the Commodity Futures Trading Commission and the Securities and Exchange Commission. I did this because of the general responsibility of the Treasury to keep abreast of matters that might have the potential of destabilizing the financial markets and to take action that might be appropriate. I also conferred by telephone on numerous occasions with

officials of the New York Stock Exchange and on several occasions with representatives of brokerage houses who were involved. Similarly, I discussed possible bank involvement or vulnerability with the Comptroller of the Currency, whose office is administratively part of the Treasury Department.

While in the beginning the situation was unclear, it was Secretary Miller's and my conclusion that the Treasury Department should not intervene--and we did not--with the Commodity Futures Trading Commission to recommend the suspension of trading in silver futures contracts either by the Commodity Futures Trading Commission or by any exchange or take any other overt action. Generally speaking, the purpose of the Treasury Department in following this matter so closely was to help assure that appropriate and timely action was taken by all who might have responsibilities and, if emergency action were necessary, to recommend same to the President. As I earlier stated, at no time did we conclude any intervention was required by the Treasury.

As to the commodity markets and the commodity futures markets themselves, the Administration has been concerned for some time that the speculative trading in those markets may well have contributed to inflation directly and, just as importantly, to inflationary expectations. For example, precious metals accounted for about .5 percent of the 1.6 percent increase in the P.P.I. in January. The increases feed through the production process and result in price increases in some products which are not necessarily reduced when commodity prices themselves go down. Furthermore, these price increases can result in subsequent increases in wage and price contracts tied to the price indices, further exacerbating inflation.

It is unrealistic to expect that any market will operate perfectly, but when leveraged speculation based on inflationary expectations results in extraordinarily wide swings or the fear of a corner unduly raises prices, the effect on the whole economy

is unnecessarily disruptive. Hence from the overall standpoint of moderating inflation, any measures that would tend to ensure that the markets operated in an orderly and efficient fashion would be useful.

An additional concern is that when any market operates in an aberrational fashion, that can have disruptive effects in other markets. Thus if forced liquidations of positions in the commodity markets should result in bankruptcies of some participants, those bankruptcies could have ripple effects in other markets and cause significant problems. While such ripple effects have been thus far contained in the recent silver incident, the risk of their spreading is present whenever unbridled speculation results in precipitous price movements. Similarly, if the financial futures markets should operate in a prejudicial way, that could impact the cash market for Treasury securities. The Treasury market is the bellwether market of our financial system and it would not be in the national interest to have that market adversely affected by speculative trading in a futures market.

Finally, Treasury remains concerned about the proliferation generally of new contracts involving future delivery or that refer to future market prices of financial instruments, currencies or indices. These have taken the form of forward contracts, contracts for future delivery or performance and of options on both types of contracts. Some of these markets are just getting started; others have grown very rapidly in the last two years. For instance, the three-month Treasury bill future contract volume exceeds the cash market in that area, the level of trading now being at about \$2 trillion annually.

As I mentioned to this Committee in February, rapid developments in these markets and explosive growth have created considerable uncertainties and placed a heavy and increasing burden on the CFTC and its responsibilities for governance. It has happened so quickly that the full significance is not yet known. Our concerns with these markets have not diminished and, as I stated in February, we are uncertain that the present

regulatory structure is able to cope with this growth and all potential problems. Although we are as close as any Federal agency to these markets, we do not fully understand them, who the participants are, what they are doing, or what economic purpose is being served. We are doubtful that anyone knows the answers to these questions and have therefore suggested that developments be carefully monitored and that new contracts not be liberally designated.

In this circumstance, the Treasury, the Federal Reserve Board and the Securities and Exchange Commission have formed a working group and with the help of the CFTC we intend to evaluate various aspects of this complex situation and arrive at conclusions as to what, if any, legislative action would be appropriate. The group has already met several times and consulted with various persons outside of the executive branch. The same group will shortly complete a study conducted over the past three months of the GNMA forward contract market. That study will provide some suggestions for dealing with some of the problems in that area.

You have also asked for our views on several specific proposals for legislation, the possible need for additional regulatory authority over margins and speculative position limits. While we are not in a position to make definite recommendations at this time, I would like to make a few brief comments.

Margins play a role in the futures markets different from their role in the cash markets for equities and debt instruments. Unlike the cash market, where margin determines the level of credit extended to pay for securities, in the futures market, margins act as a performance bond for future payments. Furthermore, in the futures area, there is an additional difference between the initial margin, or earnest money, and the maintenance margin which serves to assure that contracts are marked to market by daily cash settlement of gains and losses. Easy analogies are likely to be deceptive.

It is also clear to us -- after relatively brief study -- that the design of margins (whether to regulate credit or to assure performance) may be subject to quite different considerations if a tangible commodity is involved -- as opposed to a financial future. Similarly, the necessity or desirability of position limits may also turn on the type of market involved. This is not to say that a revised regulatory scheme for margins and position limits may not be desirable, but the construction of a new system should take account of the very different basic markets involved and the likely evolution of these markets. Before making any legislative proposal, or supporting any proposal, we believe it is essential that the markets and the regulatory processes be properly analyzed. We are proceeding with that task.

These are large, complex and important issues. There is a relationship between the immediate concerns arising out of developments in the silver market and those being addressed by a number of other regulatory bodies and Congressional committees. The concerns in the futures area are closely related to those in the forward market area and the options markets. In the options area regulatory jurisdiction is split between the SEC and the CFTC with some areas remaining unregulated. Both the securities and the commodities industries are proposing and planning increases in options trading.

We would suggest that a piecemeal approach, without understanding of the full implication of actions, might well compound rather than facilitate resolution of the challenges facing these markets.

Statement by Paul A. Volcker

Chairman, Board of Governors of the Federal Reserve System

Mr. Chairman, I am pleased to be here today to discuss with your Subcommittee some of my impressions and reactions to the recent chain of events in the silver market with emphasis on their implications for public policy. Even now, however, I am not satisfied that we in the Federal Reserve and others in appropriate government agencies have fully digested all of the facts and circumstances that threatened a few sizable financial institutions and the financial markets generally. But, it is clear to me that that episode does--in an all too vivid way--raise important questions about the structure and regulation of "futures" and "commodities" markets. We intend to pursue those questions as quickly and as dispassionately as we can, looking toward recommendations for government and private actions.

The Federal Reserve does not have direct statutory or regulatory authority over any commodity or financial futures markets. We do have statutory authority to establish margin requirements for the purchase or carrying of equity and equity-type securities. And, in cooperation with the Treasury, we have a more limited and informal oversight responsibility for the government and government-related securities markets.

While our direct authority does not extend to the "futures" markets, the commodity markets generally, and the gold and silver markets specifically, we do have a continuing interest in the performance and functioning of those markets. That interest arises in several contexts. For example, to the extent that price trends in those markets, or in segments of those markets, radically depart--for whatever reasons--from general price movements (as was the case with gold, silver and other commodities during late 1979 and early 1980) they can directly and indirectly fuel inflation and inflationary expectations. Recurring headlines detailing the sub-

stantial and cumulative rise in gold and silver prices, for example, surely worked to reinforce inflationary expectations in 1979 and early 1980. Indeed, it was largely for this reason that the Federal Reserve, in October 1979 and again in March 1980, called specific attention to speculative tendencies in the commodities markets and requested banks to avoid speculative lending.

The Federal Reserve's general interest in these markets also stems from its responsibilities for promoting the efficient and effective functioning of the financial markets. That interest is obviously more pointed in certain interbank and government securities markets, but financial markets in the United States and around the world have become integrated to the point where it is very difficult, as a practical matter, to segregate one market or one institution from others. For example, some of the institutions with the greatest exposure in the silver situation had far-flung activities in many other markets. Had one of those institutions become insolvent, the problem would have quickly spread to other markets many of which are far removed from silver. Because of the interdependence of our financial markets, the Central Bank must be prepared, as in the commercial paper crisis surrounding the bankruptcy of Penn Central in 1970, to take appropriate steps to insure the continued viability and integrity of the markets, particularly in times of stress. To fulfill this function, the Federal Reserve must have at least a general awareness of trends and developments in all sectors of the financial markets.

Finally, the Federal Reserve has a direct and immediate interest in the extent to which credit is used to finance transactions in financial markets. That interest can take any of several forms including a concern about credit financed speculation, a concern about the diversion of credit from more productive uses, or a concern that an excessive use of credit for

these purposes can ultimately threaten the safety and soundness of individual financial institutions. And, in the recent silver situation, it would seem that, at least to a degree, all of these areas of concern were present.

Looked at from any or all of these vantage points--or from a more encompassing perception of the national interest--it seems clear that there is need for a throughgoing study to determine the kinds of legislation or regulatory remedies that are required to check potential abuses or excesses in these markets. While I have no firm view at this time as to specific actions that should be taken, I do have strong opinions about the types of questions that need to be examined in order to make decisions intelligently and productively.

The first of those questions relates to the character of the markets themselves. Some tend to use the term "futures market" as if it were a clear term of art which conveniently encompasses the full range of instruments and assets that are traded for forward delivery. In fact, all one needs to do is look at the pages of the Wall Street Journal to capture the diversity of these markets. Agricultural products, metals--precious and otherwise--foreign currencies and Treasury and other securities are all now actively traded on exchanges which historically were developed for quite limited and specialized purposes. Indeed, it has been less than five years since financial futures were first traded on organized exchanges.

Further, in most cases, futures markets are inexorably tied to an underlying asset that trades actively in cash or spot markets not just here in the United States but around the world. These markets, whether viewed from the perspective of the relationship of the "spot" price to the "futures" price or from the perspective of the London price to the New York price are highly interdependent, and that interdependence is a reality which must

weigh heavily in our deliberations as to the appropriate regulatory framework for the future. At the extreme, for example, we must recognize that excessive regulation may simply work to drive activity off the organized exchanges or offshore where the threat of abuse to the detriment of our own investors and institutions will be increased.

At this point, I am inclined to the view that all forward and futures instruments should not be treated alike. More specifically, I believe it is possible to distinguish "financial" futures from other forward-type instruments and that such a distinction may be appropriate from the viewpoint of public policy. Certainly, futures in Treasury securities, foreign exchange, and perhaps gold and silver to name a few, do have characteristics--including low costs of transportation and storage in proportion to value--that distinguish these instruments from futures in wheat or other agricultural products. "Financial" futures, moreover, are of more direct and immediate interest to the Treasury and the Federal Reserve than are traditional agricultural futures, since they obviously have more direct potential for influencing developments in financial markets and markets for international exchange.

Any consideration of possible changes in the regulation of futures markets must, of course, take into consideration the whole question of the form and amount of margins. As the Subcommittee knows, initial margins in these markets have traditionally been quite small--generally only large enough to cover one day's maximum expected price movement--and participants have been able to meet these requirements not only with cash but with other forms of collateral. In the main, however, the markets rely on maintenance margins to insure contract performance. Under these arrangements positions are marked to market daily, and cash payments are funneled through the clearing houses from the daily losers to the gainers.

The exchanges have worked out these margin arrangements in order to keep capital costs low so as to permit participation by legitimate users of the market. While this approach is quite understandable, however, it must be recognized that the initial margins held by the exchanges (or the clearing house) are the first line of defense in the event liquidity or other problems develop with individual brokers or their customers. Because of this, the level and the form of initial margins do have importance for the integrity of the markets generally.

Margins on futures contracts are a kind of performance bond, as money or other assets are put up in advance of a purchase to provide assurance that contractual obligations will be met. Thus they differ from the margin that pertains to the acquisition of securities which involves an extension of credit to help finance an immediate purchase. Despite this clear distinction, however, the point should be made that in some instances credit is indirectly involved in meeting margins on futures contracts. In the recent silver situation, for example, it appears that some participants relied heavily on borrowed funds to meet margin maintenance calls. This raises the question then as to whether there should be regulations either limiting the amount of credit that may be used to finance the acquisitions or maintenance of positions or whether, at the least, there should be regulations governing the kinds of collateral that may be used to finance such credits.

Aside from the credit questions there are other issues with regard to margins that need to be explored. For example, under present arrangements the Commodity Futures Trading Commission has only emergency powers to set margins, which, as I understand, have only been used once. The basic authority to set margins and other terms of trading lies with the exchanges. Since the exchanges are in competition with each other, this arrangement, inevitably, raises the question of competition in laxity. Thus, while this

arrangement apparently has, with a few exceptions, worked well, I cannot help but conclude that it too should be reexamined. I reach this conclusion not just because of the obvious question whether, in the process of setting and changing margins, legitimate self-interests of the exchanges can be separated from the broader public interest. In addition, it seems to me that some form of direct governmental participation in the process of setting margins and other terms of trading would, by elevating these decisions to the realm of public policy, clearly work to remove inevitable pressures from the exchanges that must arise in the context of setting such margins.

There is also a question in my mind as to the manner in which margins are administered. Initial margins, as noted earlier, are understandably low. These low margins, however, permit a considerable amount of leverage. And, moreover, because of the policy of funneling maintenance margin payments from losers to gainers, there is the clear potential, which we may have seen in silver, for the pyramiding of positions to thus achieve still greater leverage. All of this raises the question in my mind as to whether it might not be practical and appropriate--at least in some circumstances--to limit in some fashion the cash payments made to those on the "plus" side of the market in connection with the daily marking to market.

This range of questions and issues is meant to be illustrative, not exhaustive. There are many others that also need to be examined--the potential use of position limits, and the nature of surveillance activities across futures exchanges and into the cash market, among others--before reasoned judgment can be made about the nature of regulatory measures that might be needed in this area. And, it seems to me that only when we have answered those questions, will we be in a position to judge effectively how any new regulations can best be administered.

There are several government agencies, including the CFTC, the SEC, the Treasury and the Federal Reserve that have a natural interest in at least some segments of these markets. Conceivably, authority for the regulation of these markets could be vested with any one of these agencies or perhaps divided among the agencies. Alternatively, it could be placed with an oversight Board or Commission with representatives from all of the agencies, as well as with representatives of the exchanges or the public. Ultimately, however, that judgment is best made in a context in which some of the issues I have raised are more fully analyzed. We in the Federal Reserve, in cooperation with other government agencies, have undertaken a broad-based study of these and related questions, and I fully expect that the primary result of that effort will be a set of legislative recommendations that would be submitted to the Congress. That effort will take some time.

In concluding, let me make two final observations. First, I am fully aware that some would argue that the recent episode in the silver markets should not be cause for concern. This position appears to be based on the point that, in the final analysis, the situation worked itself out without major and permanent damage. There may be something to that assessment, but from my vantage point it was simply too close a call to permit us to take the liberty of a "business-as-usual" attitude.

Secondly, I would also emphasize that the silver episode illustrates, very forcefully, the kinds of distortions, instabilities, and risks associated with unchecked inflation. Indeed, in a manner far more convincing than the best of our economic studies, or the most resounding rhetoric, this situation can serve as a reminder to us all of the importance of standing fast in our efforts to bring inflation under control over time.

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PREPARED STATEMENT OF HON. IRVING M. POLLACK,
COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION,
BEFORE THE SUBCOMMITTEE ON CONSERVATION AND CREDIT
OF THE HOUSE OF REPRESENTATIVES COMMITTEE ON AGRICULTURE
(May 21, 1980)

Mr. Chairman, and members of the Subcommittee:

In response to the request of Chairman Jones, I am pleased to appear today as the Commission's representative in connection with the Subcommittee's hearing on recent events in the silver futures market and their implication for the Federal Government's authority to adequately regulate commodity futures trading. The events in the silver futures market have underscored the sensitive nature of this country's organized securities markets and futures markets and the close inter-relationship between those markets. Since the precipitous decline in silver prices on March 26 and 27, the Commission has closely monitored the financial condition of broker-dealer firms affected by that trading. In addition, the Commission has begun an inquiry into the circumstances surrounding the silver market break insofar as they may have impacted on the securities industry and, in this regard, is coordinating with the CFTC and other interested agencies to ensure that our inquiry proceeds expeditiously and avoids unnecessary duplication of regulatory effort.

As you may know, Chairman Williams of the Commission has testified twice before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Committee on Government Operations; and once before the Subcommittee on Agricultural Research and General Legislation of the Senate Committee on Agriculture, Nutrition and Forestry. Each of these Subcommittees have their own inquiries into the silver trading of March. I am attaching copies of the two prepared statements given before these Subcommittees for your information.

During Chairman Williams' testimony before the House Subcommittee on Commerce, Consumer, and Monetary Affairs, Chairman Rosenthal asked for his comments on legislative changes which might be enacted to reduce the likelihood of recurrence, or minimize the impact, of sharp declines in futures prices as experienced in March. Chairman Williams suggested at that time, and I reiterate here, that the Congress should provide the Board of Governors of the Federal Reserve System with the authority to adopt margin requirements for all futures trading, which would be

comparable to the authority that the Board of Governors exercises over equity securities and options on those securities. I believe that the extension of credit to a customer writing an uncovered put or call option, which is subject to the Board of Governors' margin regulations, is functionally similar to the "good faith" deposit made by one who sells a futures contract, which is not subject to the Board's requirements. Authority to regulate the amount of credit which may be extended in futures trading will provide the Board of Governors with an effective tool to curb excessive speculation in that market, and to channel investment capital into more productive areas. Another important result would be the protection of investors, particularly small investors, from excessive risks incurred by trading upon little or no margin.

In addition to the extension of margin authority to the Board, a number of suggestions have been made to enhance the authority of the Commodity Futures Trading Commission under the Commodity Exchange Act. I do not profess to be expert in these matters. However, it would appear useful to provide the CFTC with whatever additional authority may be needed to enable that agency to obtain full and accurate reports concerning cash market trading activity.

I want to make clear that this Commission does not seek any regulatory responsibility over trading in agricultural and other tangible commodities or futures on those commodities. This has been our position in the past and continues to be our position. Indeed, in responding to the recommendation of the General Accounting Office in 1978 that this Commission assume the responsibilities of the CFTC, we specifically advised the GAO that the Commission perceived no need for a transfer of responsibility over trading in futures on tangible commodities in view of the differences between that market and the securities market.

The Commission does have a serious interest, however, in ensuring that the fairness and orderliness of the securities market and the efficient allocation of investment capital are not impaired by disruptions in the futures market. In this regard, the Commission is actively considering whether its net capital rules, and other financial responsibility rules, should be revised to shield more effectively the securities activities of broker-dealers from risks they may incur in connection with their commodity futures trading.

**PREPARED STATEMENT OF SEN. HAROLD W. WILLIAMS, CHAIRMAN,
SECURITIES AND EXCHANGE COMMISSION BEFORE THE SUBCOMMITTEE
ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS OF THE
HOUSE OF REPRESENTATIVES COMMITTEE ON GOVERNMENT
OPERATIONS (April 14, 1980)**

Mr. Chairman, and members of the Subcommittee:

In response to the request of Chairman Rosenthal, I am pleased to return today to discuss recent events in the silver market, their impact upon the Nation's capital markets and upon the securities industry, and the implications for regulatory or legislative measures which might be taken to prevent, or reduce the likelihood of, a recurrence of these or similar market disruptions. While the Commission and other federal agencies are still engaged in learning all the facts surrounding the precipitous decline in silver prices in March, this episode has already served to underscore the exceedingly sensitive character of this country's organized securities markets and futures markets, and the close inter-relationship of those markets.

In its invitation to appear today, the Subcommittee requested that I address three specific areas, to which I now turn.

1. The Subcommittee first asked for a status report on the publicly-held companies, securities, and broker-dealer firms most affected by March silver trading, and the after-shocks, if any, which may be expected in the days and weeks ahead. With regard to the brokerage firms, the staff of the Commission has been in contact with those major firms known to have held substantial positions in silver futures, particularly those firms having significant dealings with the Rents. On the basis of the information provided, we have reasonable assurance that no such firm is presently in financial difficulty as a result of its dealings in silver or silver futures. With regard to the status of publicly-held companies and the markets for their securities, I am sure the Subcommittee is aware of the publicity that has surrounded two public companies in particular, Bechtel Group and Englehard Mining, both of which were involved in substantial silver dealings with the Rents and experienced temporary halts in the trading of their stocks. Since the silver market break on March 26-27, Bechtel has publicly disclosed receiving approximately \$40 million in cash payments from the Rents on

their silver account deficits and has confirmed the Hunts' intention to pay any further amounts due to cover their silver-trading losses. The Commission further understands that Englehard, a major metals trading company, has reached settlement with the Hunts as to certain recently matured silver contract obligations, reportedly on favorable terms. Thus, it appears to the Commission that both companies have emerged from the March silver trading and their Hunt dealings without a continuing threat to their financial viability. As for other public companies, while of course those with heavy silver involvement, particularly small silver mining companies, have seen the market price for their stock erode substantially in the past couple of months, we are aware of no major public company that is now in jeopardy as a result of its dealings with silver or silver futures.

What the longer term impact on the financial markets will be from this experience is more difficult to assess, as I am sure you are aware. We do believe that the protective actions taken by brokerage firms in the midst of the silver crisis have substantially reduced the exposure of the brokerage community to further volatility in silver prices, particularly in Hunt will likely experience any more severe aftershocks caused directly by the recent upheaval the silver markets.

The Commission's concern over the events of the past month, of course, has not abated because the immediate threat to the securities markets from the silver problem appears to have passed. The Commission has commenced an inquiry into the circumstances surrounding what has transpired. While it is premature to comment on what findings that inquiry may turn up, the Subcommittee should be aware that we are coordinating with the CFTC and other interested federal agencies to assure that inquiry proceeds expeditiously without unnecessary duplication of regulatory effort. In addition, the Commission is actively considering whether changes in its financial responsibility rules, particularly, in the net capital area, should be made to protect the securities activities of broker-dealers from undue exposure to commodity trading risks. I wish to assure the Subcommittee that we are pursuing our existing regulatory alternatives vigorously.

2. The Subcommittee also asked for our comments on proposed amendments to the Commodity Exchange Act proposed in May, 1978 by the General Accounting Office.

At the outset, I would like to point out that the CFTC and the Commission have undertaken in good faith to consult with each other on matters of mutual regulatory concern, both before, and after, Congress mandated consultation between the two agencies in the Futures Trading Act of 1976. However, our experience over the last two years, indicates the shortcomings inherent in a legislative scheme which bifurcates regulatory responsibility with respect to underlying securities and derivative instruments based on those securities, and then attempts to bridge the information gap created by that bifurcation through a requirement of inter-agency consultation. While refinements can, of course, be made to the mechanics of inter-agency consultation, the Commission believes the sounder, more efficient legislative approach is one which provides, to the greatest extent practicable, for vertical integration of regulatory responsibility. Under this approach, the agency with authority to regulate the cash or "spot" market in a commodity or security should also have regulatory responsibility over all instruments which create a right, or obligation, later to acquire or sell that commodity or security.

The three amendments to the Commodity Exchange Act proposed by the GAO in 1978 offer a possible way to provide for the vertical integration of regulatory responsibility. The first amendment would exclude from the Commodity Exchange Act's definition of a "commodity", securities which are subject to the registration provisions of the Securities Act of 1933 and any index composed of such security or an aggregate of such securities. By doing so, the amendment would refocus responsibility over futures on stocks, stock indexes, and corporate debt instruments in a manner which I believe would provide for a more effective regulatory scheme. An alternative way to achieve this result would be to use the criterion of registration for the trading of securities under the Securities Exchange Act of 1934 as a reference, instead of the 1933 Act's definition, thereby providing perhaps greater certainty over the types of securities to be covered. At this juncture, I do not necessarily favor one approach over the other, but I believe this technical drafting matter may warrant further study.

The second amendment to the Commodity Exchange Act proposed by the GAO would ensure that no gaps in regulatory responsibility would result by

excluding certain securities from the definition of "commodity". In effect, the amendment would divide the area into three parts -- futures on tangible commodities and services, futures on securities subject to registration under the Securities Act of 1933, and futures on securities -- for example, Treasury bills -- that are exempt from the 1933 Act's registration requirements.

The amendment would make clear that the CFTC retains responsibility for futures traded on tangible items and services encompassed by the definition of "commodity". Those items would include traditional commodities which are properly within the regulatory ambit of the CFTC. And, by otherwise retaining the broad definition of "commodity", the CFTC could continue to respond creatively to the market's call for new risk management devices.

As to futures on securities subject to registration under the Securities Act of 1933, the GAO amendment would make clear that those futures are themselves "securities" subject to the full panoply of the federal securities laws administered and enforced by this Commission. As mentioned, we support the concept of vertical integration of regulatory responsibility, and this proposal would accomplish that approach.

As to futures on exempt securities, such as Treasury bills, the proposed amendment would clarify that the CFTC would continue to exercise regulatory responsibility with respect to those futures, while allowing the Commission to bring antifraud actions. In this area, the Commission believes that serious consideration also should be given to accommodating the interests of those federal agencies which now have responsibility over the cash markets in government securities. It is only through such a carefully coordinated approach -- coupled with a meaningful opportunity for concerned federal agencies to bring their expertise to bear on the regulatory process -- that we can assure the continued vitality of this important national asset.

The third amendment to the Commodity Exchange Act proposed by the GAO in 1978 would create a "Council on Regulation of Securities Futures" comprised of representatives of the Department of Treasury, the Commission, and the CFTC, and other interested federal agencies designated by the President. The Council would have no direct regulatory responsibility but would make recommendations on particular futures contract applications

to the appropriate agency before which the contract may be pending. I believe that establishment of a Council of this sort would be salutary, but only if done as a supplement, rather than as an alternative, to the legislative scheme I have outlined above.

3. In a third area of inquiry, the Subcommittee has asked that I discuss the possible effects on the securities industry of a corner on an underlying cash commodity or manipulation of a particular futures contract. The answer to this question depends, in large measure, upon the nature of the underlying commodity.

Where the underlying commodity is a security, a "corner" — more properly described in securities parlance as an attempt to acquire control over an outstanding class of securities — may actually further a legitimate economic activity if, for example, the security is acquired pursuant to a tender offer, issuer repurchase or other acquisition program conducted in accordance with existing statutory and regulatory requirements. Where futures are traded on a security, however, it is conceivable that sizeable acquisitions of the underlying security may be attempted to "squeeze" persons who hold short positions in the futures contract. If successful, acquisitions of this type could increase the price of the underlying security in response to a contrived imbalance in supply and demand. As the available supply of the underlying security is diminished, those seeking to cover short positions in the future will be forced to pay an inflated price.

If the investor in the acquisition program changes his investment strategy in the underlying security, or worse, only took a position in the underlying security for a manipulative purpose, when the securities are released back into the market, there may likely be a precipitous drop in price, to the detriment of investors who bought the security at the price affected by the acquisition program or manipulation. Moreover, those customers who financed the initial purchase of their securities will be required to deposit additional margin. If customers fail to meet maintenance

margin calls, brokers will be required to liquidate their customers' positions, and, in so doing, may incur losses if proceeds from these sales fall short of the sums originally lent to their margin customers.

With respect to manipulation of a futures contract on a security, if the price of the future is manipulated upwards, those who hold short positions on the future will be required to deposit additional margin. And when the futures contract returns to a normal price, those who bought at the inflated price will be required to post margin or sell at a loss. To the extent that purchasers or sellers fail to meet margin calls, losses may be incurred by their brokerage firms, who must cover their customers' defaults. Moreover, to the extent that prices of futures on securities influence the price of the underlying securities, additional losses may be incurred by investors in the cash markets.

Where corners occur in tangible commodities and services and manipulations take place in their respective futures, the effects on the securities markets and the brokerage industry will be less direct, though potentially significant. Most importantly, as the March Silver trading experience demonstrates, the use of securities as collateral in commodities accounts effectively links, in certain respects, the commodities and securities markets. If a commodities customer fails to deposit additional collateral to meet a margin call, the brokerage firm must liquidate the securities collateral, which may drive down the price of those securities. If the proceeds are insufficient to meet margin calls, the brokerage firm may sustain losses, which, in turn, may put the firm in net capital violation. Finally, on a more general level, disruptions in the futures markets and threats to the solvency of brokerage firms can only serve to undermine investor confidence in the markets as a whole.

PREPARED STATEMENT OF HON. HAROLD H. WILLIAMS,
 CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION
 BEFORE THE SUBCOMMITTEE ON AGRICULTURAL RESEARCH
 AND GENERAL LEGISLATION OF THE SENATE COMMITTEE
 ON AGRICULTURE, NUTRITION AND FORESTRY
 (May 2, 1960)

Mr. Chairman, and members of the Subcommittee:

In response to the request of Chairman Stewart, I am pleased to appear today in connection with the Subcommittee's hearing on recent events in the silver futures market. These events have underscored the sensitive nature of this country's organized securities markets and futures markets, and the close inter-relationships between those markets. Since the precipitous decline in silver prices on March 26 and 27, the Commission has closely monitored the financial condition of broker-dealer firms affected by that trading. In addition, the Commission has begun an inquiry into the circumstances surrounding the silver market break insofar as they may have impacted on the securities industry and, in this regard, is coordinating with the CFTC and other interested agencies to ensure that our inquiry proceeds expeditiously and avoids unnecessary duplication of regulatory effort.

As you may know, I have provided testimony on two occasions during this past month before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Committee on Government Operations, which is conducting its own inquiry into the silver trading of March. I do not propose to repeat that testimony in my prepared remarks today, although I would be happy to respond to any questions which members of the Subcommittee may have in this regard. At this point, I would like to address three questions which the Subcommittee raised in its invitation for me to appear here today.

First, the Subcommittee has asked that I comment on various legislative proposals which have been suggested since the events of late March. I would point out that, so far as I am aware, no bills have been introduced in either chamber that deal with this matter. During my testimony before the House Subcommittee on Commerce, Consumer, and Monetary Affairs, Chairman Rosenthal

asked for my comments on legislative changes which might be enacted to reduce the likelihood of recurrence, or minimize the impact, of sharp declines in futures prices as that experienced in March. I suggested at that time, and repeat here, that the Congress should provide the Board of Governors of the Federal Reserve System with the authority to adopt margin requirements for all futures trading, which would be comparable to the authority that the Board of Governors exercises over equity securities and options on those securities. Authority to regulate the amount of credit which may be extended in futures trading will provide the Board of Governors with an effective tool to curb excessive speculation in that market, and to channel investment capital into more productive areas. Another important result would be the protection of investors, particularly small investors, from excessive risks incurred by trading upon little or no margin.

In addition to the extension of margin authority to the Fed, a number of suggestions have been made to enhance the authority of the Commodity Futures Trading Commission under the Commodity Exchange Act. I do not profess to be expert in these matters. However, it would appear useful to provide the CFTC with whatever additional authority may be needed to enable that agency to obtain full and accurate reports concerning cash market trading activity.

Second, the Subcommittee has asked about the legislative and historical basis for the Commission's interest in the trading of commodity futures. Based upon subsequent discussion between the Committee staff and Commission staff, I understand that this question is directed toward futures on tangible commodities — such as corn, wheat, and silver — and not futures on securities. The answer is quite straightforward. The Commission does not seek regulatory responsibility over trading in tangible commodities or futures on those commodities. Indeed, in responding to the recommendation of the General Accounting Office in 1978 that this Commission assume the responsibilities of the CFTC, we specifically advised the GAO that the Commission perceived no need for a transfer of responsibility over trading in futures on tangible commodities, in view of the differences between that market and the securities market. The Commission does have a serious interest, however, in ensuring

that the fairness and orderliness of the securities markets and the efficient allocation of investment capital are not impaired by disruptions in the futures market.

Third, the Subcommittee has asked for a discussion of this Commission's activities with respect to commodity futures during the six months prior to March 27. I am advised that this question is directed specifically at trading in silver futures. During the six months prior to the market break of late March, this Commission was not engaged in any regulatory activity focused specifically on silver futures trading, since that market is beyond the Commission's direct jurisdiction. I would advise the Subcommittee, however, that the Commission is continually engaged in the enforcement of its net capital rule applicable to broker-dealers. Indeed, the Commission has had for some time "early warning" rules which require a broker-dealer firm to provide immediate telegraphic notice to the Commission when the firm's net capital position, even though not violative of the net capital rule, approaches certain levels. The existence of this "triggering" device contributed to the Commission's ability to monitor the financial position of brokerage firms during the March silver break. As a result of the March experience, moreover, the Commission is actively considering whether its net capital rules, and other financial responsibility rules, should be revised to shield more effectively the securities activities of broker-dealers from risks they may incur in connection with their commodity futures trading.

* * *

I thank you again for the opportunity to address this Subcommittee, and I shall be happy to respond to any questions.

STATEMENT OF WALTER GOLDSCHMIDT, CHAIRMAN
CONTICOMMODITY SERVICES, INC.

My name is Walter Goldschmidt. I am Chairman of ContiCommodity Services, Inc., a subsidiary of Continental Grain Company. With your indulgence, I would first like to say a few words about my background and about ContiCommodity.

Mr. Chairman, I grew up in the grain business. I began as a runner on the Chicago Board of Trade, and, as I moved through my career, I learned first-hand the vital role that the futures market and futures trading play in the marketing of grain and many other products. In addition, I have always been very active in exchanges, having had the privilege to serve as President of the Milwaukee Grain Exchange and as a director, for six years, of the Chicago Board of Trade. I also participated in the creation of ContiCommodity Services, an organization which since its founding ten years ago has emerged as one of the leading futures merchants in the United States and abroad. We are members of all the major futures exchanges, and trade in all commodities, including silver. Although Conti has many customers in silver, neither the Hunt brothers nor any of the companies they control traded silver at Conti.

Because of my extensive participation in the futures industry, and my concern for it, I am most pleased to be here today, at your invitation, to share with you my views concerning the operation of the silver futures market in recent months, and the adequacy of the regulatory authority of the Commodity Futures Trading Commission.

I can readily appreciate that this Subcommittee, which, together with its parent, having legislative jurisdiction over the commodities exchanges, is concerned with the violent fluctuations that occurred in the silver market during

the period between September 1979 and April 1, 1980; but, let me assure you that the system which you have helped to create under the Commodity Exchange Act functioned satisfactorily under extremely adverse circumstances.

The futures market system reflects price; it does not create the conditions that make price. For me, the most salient aspect of the recent events has been that the system worked, that the market, in the final analysis, prevailed. Every clearing member met its obligation. No participant in the market -- either the speculator or the commercial hedger -- suffered from the failure of the system itself. The system proved itself, as it has so many times in the past, to be bigger than any participant. Consequently, we must, and I am sure you will, be very wary of tampering with a system which has provided the hedging mechanism and price discovery function so vital to our agricultural sector and to our entire economy.

What, then, caused this unprecedented and undesirable volatility of the silver market? The silver market is a very large one. It is truly an international market, and is particularly immune to any form of price manipulation. My life-long experience as a trader, and as a hedger in the futures market leads me to conclude that the dramatic rise and fall of silver prices was largely a response to fundamental market forces.

It is now common knowledge that individuals with substantial means began to accumulate large amounts of silver in 1979. This accumulation occurred during a period not only of high inflation but of expectations of even greater inflation, a period when the return on cash and capital was far below the inflationary rate, a period of relatively low interest rates, a period of unsettling international events

such as Iran and Afghanistan and a period of high currency fluctuations. All these factors made it attractive to own precious metals, particularly gold and silver, rather than cash. It is not surprising that both silver and gold prices peaked on the same day. They were particularly attractive when the whole world was trying to convert cash into tangible assets. Gold and silver are easily stored, and transferable. They have universal value and are not directly subject to currency fluctuations. Given the interplay between the relatively low interest rate and soaring inflation against the background of international crises, gold and silver were a logical hedge for individuals with substantial assets.

Markets are not perfect. They move in excess both on the up side and the down side. As the silver market began to rise dramatically, the exchanges became concerned and took steps to prevent "excessive speculation." They have many tools available to them. The first one they used was to substantially increase the margin requirements. In my opinion, as they repeatedly raised the margin requirements, they made the market less liquid by restricting participation to those who either had very substantial means, or had made a lot of money in the market by being on its long side and could use their profits to meet the higher margins. The high margins stood as a barrier to increased participation by forces on the short side of the market, not only the speculative community but hedgers as well. Our experience has been that markets which have broad and extensive speculative participation are the most valuable for hedging. We also find that the converse is true. Hedgers are reluctant to participate in a market that is volatile and illiquid. The sharp rise in margin requirements, by unintentionally increasing the volatility and illiquidity of the silver market, had the effect of

driving out the hedgers. So, contrary to the popular belief that raising margins will reduce price levels, I submit to you that the excessive use of that tool caused the silver market to peak higher than it would have otherwise if the margin tool had been used with more restraint.

Another consequence of the actions taken by the exchanges was that nearby and spot silver sold continuously at a price well below the distant months. Even with the cost of carrying silver, it was always attractive to take delivery and hold silver rather than to sell or switch to distant months. I am convinced -- as a matter of fact, I know -- that many of the participants would not have taken as much physical silver, and would either have divested themselves of some of their holdings or moved them to deferred months, had the market force been permitted to operate freely.

Just as I believe that the intervention of the exchanges had the unintended effect of intensifying the natural rise in silver prices, so, too, it had the effect of accentuating the decline. When the Comex finally adopted the extreme measure of permitting trading for liquidation only, the Federal Reserve Board and the Government, concerned about inflation, were tightening the money supply and inducing interest rates to climb to unprecedented levels. This led to a reversal in investors' attitudes. Instead of converting cash into goods, they began converting goods into cash. The "flight to safety" phenomenon occurred. Why should I risk my capital in the commodities markets when I can receive a 15% return from U.S. Treasury-backed instruments? This psychology affected not only the silver market, but most of the other commodities in which we deal. The initial drop in the silver market was, therefore, the result of fundamental economic forces applied to

a market made thin by the actions and concerns of the exchanges. This triggered what we now know was a forced liquidation of one of the largest participants in the history of futures market trading -- causing the dramatic decline in prices. This, in my opinion, is a thumbnail sketch of what occurred.

I would like to address a few of the questions and concerns about what should be done to prevent this from happening again. I am not here to say that the fluctuation and volatility of silver prices during the last six months was desirable; on the contrary, I view such gyrations in the market as a real threat to the system of futures trading and I believe that the investigation that this Subcommittee has undertaken is a most valuable service to the futures industry and to all participants in the market.

Two issues are before us: First, should the power to set minimum margin requirements on futures contracts, which is now held by the commodities exchanges, be given to the CFTC? Second, should the power to set speculative position limits for silver be exercised by the CFTC?

As to margins: As the members of this Subcommittee are aware, margin requirements perform a function in a commodity market distinctly different from their function in the securities market. It is unfortunate that we are using the same word to explain two distinct functions. In securities markets, the purpose of the margin requirements is to prevent the excessive use of credit. When someone purchases stock on margin, there is an actual transfer of property. The seller is paid in full for stock he has sold to the buyer. If the buyer does not have sufficient funds to pay for the stock, he can and does automatically borrow the rest through his margin account. Thus, the net purchases of stock on margin can in this manner generate credit.

In commodities, by contrast, the margin functions as a security deposit, not a source of credit. The margin acts, in a commodities futures transaction, as an insurance that the contract will be performed. It is not a down payment, and when title finally passes, the buyer has to pay in full.

I refer you to the excellent paper recently prepared by Dr. Powers, formerly chief economist of the CFTC, on the role of commodities margins.

In the light of the function of commodities margins, I believe that it would be a mistake to shift margin setting authority from the exchanges to the CFTC. As I have already stated, the tool of raising margins was, if anything, over-applied by the exchanges. It is not reasonable to assume that, had this authority been lodged with the CFTC or any other governmental agency, it would have been more judiciously exercised. It is always easy to look back and conclude that one might have done something differently, but I doubt whether any agency necessarily further removed from, and with less understanding, of the market place, would have done better than the exchanges.

As far as position limits are concerned, we have lived with them in the agricultural futures markets for years. Ample authority exists in the CFTC and self-regulating exchanges to apply those measures to the metals markets. Here, in retrospect, they might have been applied to silver too late, but this is a delicate question of judgment. Position limits will be counterproductive unless they are set at levels sufficiently high not to impair liquidity and will be ineffective unless they are low enough to prevent excess accumulation of futures positions. What I am saying is that such limits must be tailor-made for each commodity and the

authority should remain in the hands of those closest to the market place to strike the right balance. If the exchanges default on their responsibility, the CFTC already possesses ample authority to set limits on speculative positions. When they are established, however, such limits should not be applied retroactively to existing positions, as they were by the exchanges here, but should be known in advance to all the market participants.

In summary, my observations are that the market responded to economic forces. It reflected the value of the underlying physical commodity. Yes, like all markets do, it moved to excess. It corrected itself, but, again, to excess. The price movement was unacceptably severe. However, sufficient regulatory authority does exist with the exchanges to prevent abuses, with ample oversight authority by the CFTC.

In closing, I would like to remind the Subcommittee of Federal Reserve Board Chairman Paul Volcker's wise observation: "I would caution against striking out with hastily conceived restrictive legislation with respect to organized futures markets. Those markets already have some considerable financial safeguards embedded in their structure. One danger from excessive regulation or the imposition of heavy costs is that activity will shift to unregulated channels, here or abroad, potentially leaving the markets more vulnerable than before to manipulation or credit weakness."

I thank you for the opportunity to participate in these discussions.

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CFTC REGULATORY AUTHORITY REVIEW

THURSDAY, MAY 22, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSERVATION AND CREDIT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Glickman, Hance, Richmond, Baldus, Daschle, Madigan, Coleman, and Marlenee.

Also present: Representatives de la Garza and Fithian, members of the full committee, and Neal Smith of Iowa.

Staff present: Robert M. Bor, chief counsel; John E. Hogan, counsel; Robert T. Lowerre and J. Robert Franks, associate counsels; Glenda Temple, clerk; Robert Cashdollar, James Johnson, Wayne Fletcher, Kathleen Garvin, Rita DiSimone, and Bernard Brenner.

OPENING REMARKS OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will come to order.

I want to welcome the witnesses and those who are here this morning. Very shortly there will be more members of the subcommittee present, but since we are 15 minutes late, I think we had better move on with the opening.

As chairman of the subcommittee, I would like to lay out the ground rules we will follow today. They are the same as yesterday, and are rather stringent. There is a reason for it, because of the necessity for time, and I want to be fair to all witnesses and to subcommittee members as well. I ask the witnesses' full cooperation, since we have a long witness list and much ground to cover.

We will hear the morning witnesses as they appear on the schedule. I ask each witness to have his written statement for the record and to summarize that statement in 10 minutes or less. We are going to call time at 10 minutes, unless you are near the end, because regardless of whether we hear it all or not, it will become a part of the record. We did so well yesterday by having time allotted like this that we are going to do it again today.

All witnesses will then be brought back to the witness table for questioning as a panel. We will have no questioning until we have finished with the morning witnesses. That should give us 1½ hours for questioning.

Each member of the subcommittee will have 5 minutes for questioning on each round. If we finish with one set of witnesses, and

go around one more time with all subcommittee members, and there is additional time left, we will take another 5 minutes. If not, we will have to recess at the regular time and submit the questions in writing. If there are other witnesses who want to be heard later for a brief statement, and we have the time, we will be glad to hear them.

I will now call the first witness, Mr. James Sibbet, Pasadena, Calif. His subject is "Let's Talk Silver and Gold."

Welcome, Mr. Sibbet, you may proceed.

STATEMENT OF JAMES SIBBET, "LET'S TALK SILVER AND GOLD," PASADENA, CALIF.

Mr. SIBBET. Thank you, Chairman Jones and members of this committee. So as not to waste your time or mine, because I have another appointment with the CFTC to show them a film on a completely computerized commodity exchange where a computer replaces and performs the function of the trading floor, I will come directly to the point.

The one and only cause for the 80-percent decline in the price of silver was some rules changes issued by the Chicago Board of Trade on January 22, 1980, of which I submit a photocopy on their letterhead as exhibit A. These rule changes were partially copycat-ed by the Comex on the same day which shows there was some collusion. Actually, they were voted on the day before, but took effect on January 22.

The London market heard about them before our markets opened on January 22, because the members of our exchanges sold the London market heavily before ours opened, causing London prices to gap down badly in silver and gold by sympathy. Thus, the members made large day-trade profits by knowing of the rule changes before the public. By the time our markets closed that day, silver prices were down over \$20.

Then, for the next week or so, there was a profit-taking rally by the members of the exchanges covering their shorts, plus some new buying by the Arabs who didn't understand. They thought they were getting a bargain. At this point, I'd like to ask how come there has been a total blackout of any mention of the Arabs' involvement in any of the other hearings? Did nobody testify about the Arabs?

Well, anyway, the Hunts were responsible for running the prices of silver up to about \$10 where they ran out of funds to buy any more. Then they persuaded the Arabs to buy some to help them. In my weekly publication called "Let's Talk Silver & Gold," the September 13 issue, which I'd like to submit as exhibit B, I mentioned this Arab buying. The price of silver then was \$12.12. Starting that very day, silver went straight up the limit for 8 days in a row.

The Arabs were responsible for running silver prices up to about \$18 where the public decided to take their profits and get out. Prices reacted to about \$16 and stayed in a trading range between \$16 and \$18 for about 2 months. At that price level, the Hunts had enormous profits which they partially used to acquire a still larger position cautiously. The Arabs did likewise, because they did not want to move prices up very much until they had made their acquisitions. What they did was absorb the public's profit-taking.

At that time, most forecasters were helping to get the public out by calling it a top. All the while, I was talking about the coming short squeeze, which would run prices up higher and faster than anyone dreamed possible. Because I was so extreme in my prediction of a super bull market coming when most other advisers were calling it a top, I had a credibility problem. Few people believed me. I gave a speech on it at the big NCMR conference in New Orleans on November 2. Still, few believed. I'd like to submit as exhibit C my letter that was distributed at that convention and the following one.

It wasn't until the Arabs took delivery of over 2,000 contracts of December silver, and the Hunts received a little over 1,000 contracts that people started to believe.

Near the top, that is around \$50, many prudent people took profits because by the time silver prices were skyrocketing out of control, many thought it could not last much longer. Silver was aided and abetted by a rapid rise in gold in response to silver's rise at first, but later as a result of Arab buying of gold, too, because of fear of the Russians' invasion of Afghanistan, and the crisis of our people getting captured.

The public not only got out of the futures market, but they sold their silverware and gold jewelry for scrap. Silver coin bags went to a 20-percent discount below melting value as the refineries became glutted with 6 months' supply of melting scrap. However, the Hunts and Arabs had no intention of selling. They were still buying a little more with profits made from earlier purchases.

I wrote in my letter of January 10 that the Hunts and Arabs could not sell because the public was no longer there in sufficient quantity to absorb any large-scale profit-taking. You can't blame the decline on the Hunts or the Arabs, either one, because they simply didn't sell.

It was simply a battle between the Hunts and Arabs on one side and the members of the exchanges who were short on the other side.

Then on January 22, both exchanges slammed shut the door and prohibited any new positions, and that is what caused the collapse. Only liquidating orders would be accepted. In exhibit B you will find that I mentioned they would do this if pressed hard enough in order to stop the bull market. I predicted this months in advance that they would do this in order to stop the bull market. They have done this in other markets in the past. That is why I was able to predict it would happen again. I even predicted in January in a speech over at Johnathan's in Inglewood, that silver would come down to \$10 if the short squeeze was destroyed and it was and it did.

The Chicago Board of Trade rules changes were more vicious than the Comex. In addition to liquidation only orders which could be overcome by simply taking delivery, the CBT required that longs could be forced into a liquidating order without delivery. One of my clients was denied delivery and forced out at a price lower than the market. Incidentally, the Hunts received their deliveries in February, but the few remaining public did not. They were forced out like severing payroll.

I tried to get an injunction on February 11 to halt such forced liquidation, but Judge McMillen in Chicago held that those who had losses should take them and then sue the CBT for damages. Injunctions cannot be granted if there is an adequate remedy at law. It wasn't till February 15 when I visited the CFTC here in Washington that I discovered that what they did was legal and there is no remedy at law. You can't sue them for damages.

Now, the question is should exchanges have the power to literally force a bear market into existence by changing the rules in order to rescue themselves? Is there a better way to control runaway bull markets without creating a devastating bear market? I think there is.

Presently, when an exchange membership feels imperiled, the law permits them to change their rules any way they want. They can even renege on their contract as the Chicago Board of Trade did. It is a license to steal. It is exactly analogous to a gambling house changing the rules of a game to favor the house after the bets are down on the table.

If a gambling house did this in Reno, the Nevada Gaming Commission would promptly shut them down. But the Commodity Futures Trading Commission conspired with the commodity exchanges to get the Hunts. The CFTC already has the power to set aside such rule changes if it so desires. In fact, these emergency rules automatically expire in 30 days unless the CFTC extends the time limit which it did in this case until March 26.

Here are my recommendations for making more responsible markets:

One, require trading position size limits of 800 contracts on all commodities, not just the regulated agricultural ones. The exchanges, themselves are now doing this belatedly. If they had done it earlier, they could have avoided any semblance of a short squeeze.

Two, require a penalty of one day's limit for failure to deliver on the contract as the Comex has and now does, but the Chicago Board of Trade doesn't.

Three, make the contract a real one, not subject to ex-post-facto changes as the CBT did. Provide heavy penalties for breach of contract including the ability to sue for damages.

Four, make the commodity exchanges reveal the fact in their advertising that rule changes may make trading hazardous.

I have already filed complaints with the Federal Trade Commission about the false and misleading advertising of the CBT which pretends to have contract which doesn't really exist and there is no remedy at law for breach of contract.

What about the future? The reputation of the CBT has sunk so low that scarcely anybody trades silver there anymore. That market is almost dead. The Comex silver volume is less than one-fifth, about the few I was just told it is less than one-tenth what it used to be in silver. Traders have switched to gold and the coin dealer market.

Also, a new method of marketing and buying silver has arisen since the commodity exchanges are no longer functioning properly. Sunshine Mining Co. successfully sold a \$30 million bond issue payable in 15 years with either cash at 8½ percent interest or 50

ounces of silver at the option of the bond holder. A large refinery is doing a similar thing with gold. Houston Oil is doing it with oil royalties. I predict that this method of producers selling commodities by issuing bonds will become commonplace and will tend to hold such commodities off the market.

Mexico and Peru are investigating the procedure. In addition to that, silver buyers are planning to do a bit different way of buying silver in the London bullion market. They are planning to store in Swiss banks silver already purchased and then use that silver as collateral for high interest-bearing certificates at 2 percent above the prime on a 5-year note callable in 1 year with a 5-percent premium.

The money thus received from the loan will be used to immediately buy more silver in London. New certificates will be promptly issued against the new silver purchased. This process will be repeated until moneylenders refuse to loan money on that basis because of too high silver prices.

Since the size of these plans already exceeds 1 million ounces to start with, the repeated sale of these interest-bearing silver-backed certificates in Europe should soon tie up a large portion of the floating supply of silver, which is not large to start with. The storage of millions of ounces of silver to back the certificates, I expect could easily run silver prices back up to all-time new highs, making it easy for the issuers to pay the high rate of interest by selling a little silver at high prices.

A new runup of silver prices would destroy the commodity futures markets in silver. They are almost dead now, because the present shorts would be trapped, since there is almost nobody left to trade with. Also, London would absorb the floating supply, leaving the shorts with no ability to deliver, I predict their demise, and they deserve it with the way they have acted.

Changing rules and laws cannot save them. Now, it is too late, because this buying will be done in London by Euro-dollars. However, if you will make the law changes I suggest, we might be able to save the copper market from a similar fate. Incidentally, gold should follow silver up.

Volcker has caused the very last dip by letting it be known that the Hunts would be forced to sell even more silver, but when he realized that this might run silver down below \$10 he relented, and saved the day by saying they didn't have to sell after all.

From hearsay, I don't know this for a fact, I have heard that Armand Hammer was kind of clairvoyant in going short in the futures market before the initial price decline. I am wondering why. I would also like to ask for a congressional investigation to see if Mr. Volcker had any T-bill future positions in the last few months, because nobody has manipulated anything quite so wildly as the interest rates up and back down again.

Thank you.

[The exhibits attached to the statement follow:]

EXHIBIT A



The
Chicago
Board of
Trade

January 22, 1980

CLARIFICATION NOTICE

The Chicago Board of Trade has received a number of inquiries concerning emergency action on Silver taken by the Board of Directors on Tuesday, January 22, 1980.

The following statement, concerning the exceptions cited in the notice of January 22, is issued in answer to these inquiries.

Spreading transactions in 1980 January, February and March Silver contracts will be permitted for the purposes of liquidation only. Spreading transactions in contracts other than 1980 January, February and March Silver contracts are permissible subject to the 600 contract limitation regulations presently in effect.

New positions, spreading or otherwise will not be permitted in 1980 January, February and March Silver contracts. New sales for delivery purposes only, transfers and exchanges for cash will be allowed.

The spreading transactions permitted in the January 22 notice under paragraph (b) are those involved in liquidation of old positions, that is, spreading or legging out of old positions in the first three months is permitted.

Thomas R. Donovan
Vice President and Secretary

EXHIBIT B



Let's talk ... Silver & Gold

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BY JAMES SIBBET

THE BEGINNING OF THE END

THURSDAY, NOVEMBER 8, 1979

This is not the end, just the beginning of it. The end should come no later than 1982-3 according to economist Dr. H. A. Merkley of the University of Dallas because by that time the interest cost of servicing the national debt will equal the net capital generating capacity of the nation.

I think it will come sooner because Dr. Merkley's prediction was made a year ago. Now, interest rates are accelerating so much that 1981 is a more likely date.

Also the prices of Silver, Gold, and oil are accelerating. In fact, they have gone up so fast and far that most advisors think a big reaction is coming as shown by the Bullish Consensus of advisors which is 47 percent for Silver and 42 percent for Gold.

The public believes them too. This runaway Silver market has been accompanied by public selling until now the public is just about out of the market. This is a very unusual situation. Usually big bull markets are caused by public buying as was the case in 1974. To be sure, the Hunt brothers triggered it by taking delivery of all of the floating supply of Silver in December 1973, a scenario I alone predicted in November, 1973. But they then just held the Silver. They did not buy during the accelerating rise. It was their selling that stopped it the last day of February, 1974. The actual buying that made prices rise so fast was short covering and public buying all the way to the top. Even after the top, the public bought again when the initial shock of March deliveries was over. Prices ran right back up over \$6 again.

This time it is quite different. The public remembers their former experience and has been selling into the rally so much that coin dealers have had great difficulty absorbing the public's sales of physical bags and bars. The public is so far out of the futures markets that volume of trading is less than one fourth what it used to be due to excessive margin requirements. The open interest has declined substantially. Trading has become so thin that the exchanges are now reducing margin requirements. Silver margin is back down to \$10,000 for 5,000 oz. of Silver bars. It was \$50,000.

If the public was selling, who was buying? Not the Hunts you may be sure. They always buy way ahead of time as they did on the 3 previous short squeezes they engineered in Silver, Sugar, and Beans. The exchange members were not buying either. They were trying to stop the rise by selling short and are now in terrible financial difficulty. The Arabs were the buyers.

I wrote in my letter of September 13 that this would happen because the man that persuaded the Arabs to buy told me so. Now, at the huge NCMR convention in New Orleans, the same man told me the Arabs and the Hunts were going to take delivery of December Silver in both markets. He didn't need to tell me. They really have no choice. To whom could they sell? The public is gone. The market is too thin unlike 1974. Also the exchange members are almost bankrupt.

When the Hunts and the Arabs do take delivery, it will bankrupt most of the exchange members. They

might barely be able to make delivery. But in the process they will go bankrupt. There is no way they can cover their short positions in the other contract months and make delivery too. The market is much too thin. For them to cover, they must find buyers at prices above \$16 after December 1.

Their only salvation is to limit trading now to liquidating orders only. Both exchanges had meetings on this subject, but rejected such a drastic rule because the charts look "lumpy." They thought that excessive margins would kill the bull market. They did stop it, and normally Silver prices should have declined to \$13 by this time. But the public is out of it. Arabs bought all the way up and still support the reactions. So, who is there to sell? As long as the Arabs are smart enough not to run prices to new highs, the exchange members will have hope of lower prices in a normal manner and will not take such drastic action to save themselves. But if they wait until deliveries are made and taken, it will be too late. Liquidation only orders will find shorts covering and longs taking delivery.

The Chicago Board of Trade thinks they can save themselves by restricting maximum positions to 600 contracts on February 1. That is too late. To be sure it will force some liquidation by the longs in later months, but it does nothing to relieve the short squeeze in December and January. Also my friend has 18 Arab accounts times 600 equals 10,800 contracts, far more than the shorts could possibly deliver after scraping the bottom of the barrel to make December deliveries.

I don't see any way out of it. It surely is the beginning of the end of the Comex at least. By not restricting trading to liquidation only, they have doomed themselves.

There are still some long-term public investors in Silver futures. But they have such huge profits, they can afford to take delivery too, and I recommend it.

The remaining open interest in the Comex December is over 11,000 contracts and declining much too slowly. The charts look so bearish, that anyone who did not wish to take delivery should have sold by this time. If by November 30 the open interest in December remains above 6,000 contracts, a short squeeze is assured. The floating supply is less than 4,000 contracts.

CURRENTLY, the technical picture was quite bearish but has now improved. Gold which had been the weakest, now has an uptrend signal. The Bullish Consensus is bearish. The Demand Index has crossed back above one for both Silver and Gold. I believe we have seen the low of the reaction. However, I think prices will stay in a narrowing trading range until the deliveries create a real short squeeze which should make previous action seem mild. Both long-term investors and traders should buy near the low side of the trading range from \$16 to \$17 basis December but traders should buy March. Investors buy June Chicago for long-term gains.

Please make hotel reservations (phone 1-714-488-0651) for the Bahai Hotel soon for the trading seminar in San Diego November 30 and December 1.

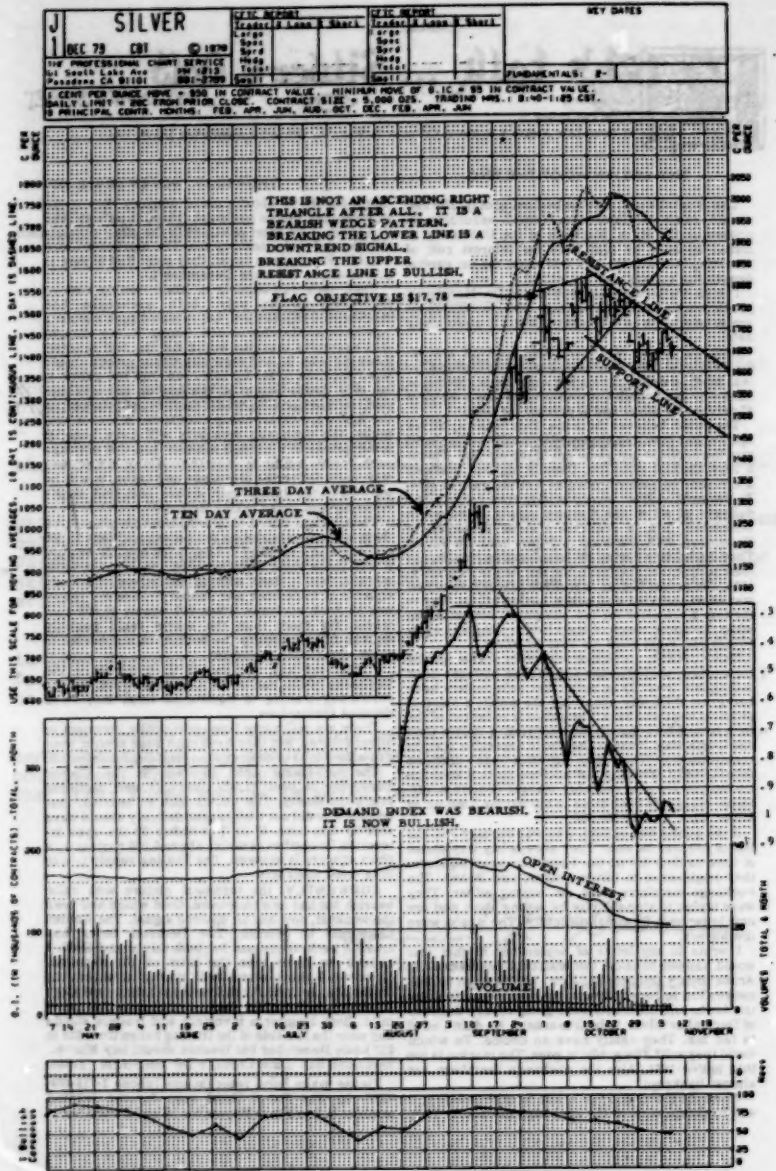


EXHIBIT C



Let's talk ... Silver & Gold

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BY JAMES SIBBET

WAITING

THURSDAY, NOVEMBER 1, 1979

Everybody's waiting for the economy to go one way or the other.

Traders are waiting for the margins to be reduced so they can trade again. Volume of trading has fallen off to very low levels of less than one third of normal. At the low day last Monday, Silver volume was only 2,261. It used to average over 15,000. Now the average is less than half of that. Most of the activity is locals trading with themselves. The public simply is not trading anymore. This makes technical analysis less reliable but it is bearish.

Investors are waiting too. There are two groups. One is waiting for a very large decline in prices so they may buy again. The other group did not sell and is waiting for the government to go bankrupt and restore the Gold standard. They also are waiting for the Arabs to take delivery of December Silver and produce an even larger short squeeze than did the Hunt brothers in 1974.

The Arabs are waiting for several things. One, they are waiting to take delivery of December Silver because there is no way they can profitably liquidate their December positions (or any other month for that matter) without causing prices to go down many limit days. They almost have to take delivery. However, there is a modest amount of "rolling-over" into March as a month to month open interest comparison reveals.

The Arabs are also waiting for the U.S. to stop inflation. Until that occurs, they will keep raising the price of oil. O.P.E.C. was organized to support oil prices. More recently it has been used by the Saudis to restrain too fast price rises. The latest word is that O.P.E.C. is falling apart with each country going its own way about raising prices. O.P.E.C. no longer serves its original purpose because there is no need to support oil prices. Even Saudi is rumored to be about to raise its price more in line with the others. The extra large trade deficit for September of \$2.83 billion doesn't ease that situation either.

The Comex members are waiting for prices to come down so they may recover their huge losses. As long as a top appears to be forming (and it does), the Comex will probably not take the drastic step of limiting trading only to liquidating existing positions. But if they wait too long, it will be too late by December. If they ever expect to recover those losses, they must take drastic action soon. The Silver market is now getting so thin, that they will have a terrible time liquidating their positions. It takes only a modest amount of Arab buying to stop a decline now, witness Monday's low volume bottom. If the Arabs are smart, they will not bid prices up to

new highs because that would cause the Comex members to give up hope of a top and make them use their ultimate weapon of **no new positions**. They think excessive margins will stop the bull market, but it only pauses.

Everybody was waiting for the results of today's largest Gold auction which turned out to be bearish. Silver went down the 60 cent limit today to \$16.05 but closed at \$16.15 for December. Gold was hard hit by the news too. December went down to \$365.5 but closed at \$373.4. Those Arabs are there supporting the reactions again.

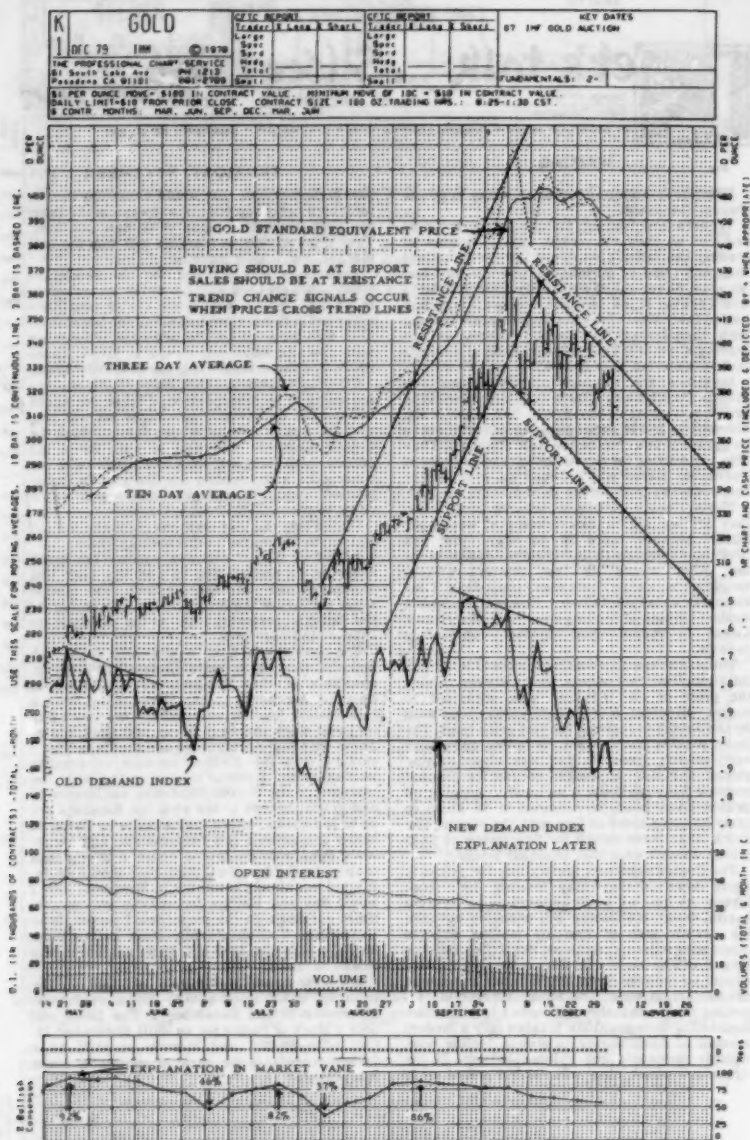
CONCLUSIONS: I think most of the waiters are going to be disappointed. I think the Arabs will not bid up Silver to new highs but will support the dips as they have been doing. I think the Comex members will wait in vain for a big decline. Also those investors and traders who are waiting for a big decline are likely to be disappointed. Also, the margins may never come down to reasonable amounts again.

I think only the long-term investor who did not sell will be the winner in this waiting game.

ADVICE: Those who are waiting for much lower prices should give up and buy near last Monday's lows and today's lows. Use mental stops just below the lows because this should be the bottom assuming the Arabs continue to support the reactions.

The problem is how to buy with such high margins. One way is to use the small size 1000 oz. contracts of the Mid-America Exchange in Chicago. Another is to buy Silver dimes from a coin dealer. Another and perhaps best is to buy common stock shares in Silver and Gold mines. Those with highest leverage are the Canadian. I would avoid the Kaffirs because of another waiting game. I prefer to wait to see what the outcome of the British-Rhodesian conference is and to wait further to see what the Russians are up to in Lusaka, where they have been flying in heavy armaments and ammunition. Any large-scale open warfare would cause a precipitous drop in the Kaffirs. Until then, they should go up. If a hot war should break out in Rhodesia, then I would buy the Kaffirs for maybe one or two times earnings. In the meantime I prefer those Canadians. You should buy them before John McFalls tells the 3000 N.C.M.R. conferees this week-end about them.

My next trading seminar will be at the beautiful Bahai Hotel in San Diego, California, November 30 and December 1. The Hotel will hold a block of rooms for us until November 15. Call 1-714-488-0551 and identify yourself as a Sibbet student to be sure of getting a room reservation.



Mr. JONES of Tennessee. Thank you, Mr. Sibbet.

You alluded to the fact that you had another appointment. Are you going to be with us until the questioning is over?

Mr. SIBBET. Oh, yes, my appointment is this afternoon.

Mr. JONES of Tennessee. Thank you very much. We will get back to you later for some questioning.

Our next witness is Mr. Brian T. Walsh, Freemarket Compensation, Salem, Mass.

Welcome, Mr. Walsh. Do you have anyone with you?

STATEMENT OF BRIAN T. WALSH, FREEMARKET COMPENSATION, SALEM, MASS., ACCOMPANIED BY CHRISTOPHER M. HINCHEY, SALEM, MASS., AND WILLIAM F. MARUTZKY, COUGHLIN & MARUTZKY, CHICAGO, ILL.

Mr. WALSH. Mr. Chairman and members of the committee, I am pleased to have this opportunity to appear before you today. I would like to thank the committee for inviting me to testify regarding recent events in the silver market, most particularly the repercussions to the investor holding contracts following the actions of the exchanges on or before January 21, 1980.

I am Brian T. Walsh, 135 Loring Avenue, Salem, Mass. I am an orchardist specializing in jojoba and macadamia nuts.

I hold a degree in economics from Boston College and did 5 years of graduate work at the University of Stockholm and worked in the area of international commodity economics. I, like many other investors, sought to prevent erosion of my savings by investing in precious metals, believing it to be a good hedge against the inflationary climate of our country.

On January 21 and 22, 1980, decisions by the board of directors of the exchanges relating to silver effectively closed the precious metals market and caused the prices of silver and gold to plummet. I became concerned with what I considered to be a change of the rules in the middle of the game without notice and, perhaps, even improperly according to the laws which govern these markets.

I was sure others like me also lost money in silver and gold as a direct result of this action. I began to inquire by telephone, letters, and one advertisement in The Wall Street Journal and ultimately was contacted by approximately 1,200 investors, who like me invested their money in silver and gold. Some invested in full or nearly full equity purchases of the metals. About two-thirds were involved in futures contracts. Collectively, this group—the majority of whom are relatively small investors—has lost, we estimate, in excess of \$150 million. This is in direct contrast to the impression given by the exchange officials and Chairman Stone of the CFTC that small investors have not lost any money.

Chairman Stone was quoted in The Wall Street Journal, March 31, 1980, as saying, "The Commission's primary job . . . is to protect small customers and not to bail out the large traders." I want to assure the members of this committee that none of the small customers that I represent received one iota of protection from the CFTC or anyone else. I have talked to farmers, small businessmen, and elderly homeowners who were virtually wiped out with no hope of recovery.

We believe that there is, at the very least, a serious question of impropriety in the actions of the exchanges.

Many of the directors of Comex, according to The Wall Street Journal, were representatives or employees of major precious metal dealers or floor brokers who had acquired short positions as the price went up. Up until now, Comex has refused to reveal whether these directors participated in the discussions and vote that led to the closure of the market except for liquidation of existing positions. Obviously this decision was not market price neutral. Anyone could have predicted the results. Prices fell drastically the next day from their historical heights and have never recovered.

We are concerned that these shorts felt financial pressures as they were paying large margins while silver and gold prices were rising, and, borrowing this money at rising interest rates were looking for a way out. We are also concerned that their bank lines may have run out just prior to January 21.

We are concerned that the emergency they defined as the reason for their liquidation only rule was not the true reason, but rather they were enduring a financial emergency. We feel there may be similar circumstances at the Chicago Board of Trade.

It is our hope and desire that this committee will investigate the circumstances surrounding the liquidation only rules, and also find the answers to the following questions:

One, what were the positions of the directors of both CBOT and Comex in gold, silver and platinum on the American and foreign markets between October 1979 and January 22, 1980? Were they short, and by how much?

Two, what was the net long or short position in gold and silver of any other traders in which the said directors have substantial interest, or which they are an employee, officer or agent?

Three, it has been stated, by Dr. Henry Jarecki, in The Wall Street Journal of April 24, 1980, that the directors of Comex openly discussed their interests in precious metals markets; what was the gist of those discussions?

Four, what precisely was the emergency which Comex and the CBOT sought to avert by the rule changes on January 21 and 22, 1980? What was the evidence leading Comex and the CBOT to believe such an emergency existed? Whether the emergency was the alleged concentration of longs or the losses sustained by the shorts.

It is noteworthy that the open interest in the March 1980 silver at Comex in January 1980 was no greater than the open interest in the March 1979 silver contract at Comex in January 1979. Also, the March 1980 silver contract was liquidated orderly and without any defaults, suggesting adequate supplies were deliverable to those who desired delivery.

Five, why was it necessary to require liquidation only in all future months?

Six, why was it necessary to refuse delivery when there was no shortage of deliverable silver in the market? What alternative did the CBOT and Comex consider? Why were they rejected? What did the CBOT and Comex expect the effect of their decisions would be on the prices in the affected commodities? In related commodities, that is, gold, platinum?

Seven, how many directors participated in the meetings held on January 21 and 22, 1980? How many voted on the issues, and what was the tally for and against? Did any of the directors reveal his position in the market in either the discussions or the votes? Are the minutes of the meetings conducted by the CBOT or Comex on January 21 and 22, 1980, available for inspection? If not, why not?

Eight, is it true that the CBOT and Comex directors, or firms they represent were required to borrow money from certain bank institutions to pay off large margins? To what extent were these large margin requirements? Is it true that just prior to January 21, 1980, these banking institutions refused to make further loans to support or finance these margin requirements? If so, could this fact have influenced the decisions made by the directors of the CBOT and Comex on January 21 and 22, 1980?

Nine, Comex in the fall of 1979 established a Silver Committee, consisting entirely of members who had no interest in silver trading, to oversee the silver futures market and to recommend necessary action—testimony of L. Berendt before Senate Agriculture Committee, May 1, 1980, pages 5-6 of his statement, "to deal with the potential congestion developing in the silver market."

Was this committee responsible for recommending the action on January 21, 1980? If not, why not? Why could not all commodities be traded under the supervision of a committee of members who are not traders in that commodity, and not affiliated with entities that trade in that commodity?

In short, in view of the great need for impartial judgment in exercising the regulating powers vested in the exchanges, is it not wholly appropriate but also essential that the members of the boards of governors be held the same standard of nonconflict of interest rules that apply to the commissioners of the CCFTC, to wit, 7 USCS (2(a)(7)(A)):

CONFLICT OF INTEREST

No Commissioner or employee of the Commission shall accept employment or compensation from any person, exchange, or clearinghouse subject to regulation by the Commission under this Act (7 USCS sections 1, et seq.) during his term of office, nor shall he participate, direct or indirectly, in any contract market operations or transactions of a character subject to regulation by the Commission.

We are concerned that the rules adopted by the exchanges and acquiesced to by the CFTC and the Federal Reserve accommodated the shorts during this period.

A member of our group who lost \$40,000 suffered an attack of high blood pressure within 48 hours after the liquidations only rule was adopted, now resulting in complete loss of sight. Others have also suffered from emotional trauma, some unable to mortgage their homes to pay off their losses.

We need to know if we have been taken advantage of by the possible self-serving interests of the exchanges' board of directors and the failure of the CFTC to exercise its responsibility.

And furthermore, we need to know if the investor, large or small, can participate in a free market system with equal rights and protection.

Mr. JONES of Tennessee. Thank you very much. We hope that you will stay around, Mr. Walsh, until the questioning session.

Mr. WALSH. I will be pleased to. Thank you.

Mr. JONES of Tennessee. Our next witness is Mr. Don Eret, a farmer of Dorchester, Nebr.

Welcome, Mr. Eret. You may proceed when you are ready.

STATEMENT OF DON ERET, FARMER, DORCHESTER, NEBR.

Mr. ERET. Mr. Chairman and members of the Subcommittee on Conservation and Credit, my name is Don Eret. I am a former aerospace engineer and now a farmer near my hometown of Dorchester, Nebr. The Nebraska American Agriculture Movement is providing for my transportation to appear at this hearing.

It is appropriate and timely that these hearings are now being held to determine whether existing law gives adequate commission authority to regulate futures trading in protecting the public interest. The Nation's economy has recently experienced the effects of a volatile silver market. The agricultural sector meantime is experiencing a commodity pricing index at its lowest point since 1933.

The current futures regulatory authority was enacted in the Commodity Exchange Act of 1936 for correcting the agricultural commodity price collapse of the 1930s. Consideration should now be given to whether rules established then are adequate now, two generations later. The subcommittee proposes to evaluate speculative position limits and margin requirements. New measures need to also be assessed for regulating the commodity futures of the 1980s, such as a pricing window as one possibility.

Rule generalization is questionable when the futures institution trades in such varied economic categories as production agricultural commodities, processed agricultural commodities, precious metals, and financial paper and interest rates.

A futures trading rule legislated specifically for production agriculture commodities appears to be justified because Congress spends many hours to legislate, or to defeat legislation, on price support and production control measures for the USDA to carry out its major duty of providing price and income protection for farmers. It is also becoming a matter of record that the Congress and the administration are reducing budget proportions to operate agriculture production support programs.

There are problems with relying on the effects of speculative position limits and margin requirements as solutions to protect production agriculture in the marketplace. The position limits can still aggregate to huge open positions adverse to producers simply on the basis of population potential of speculators. The current excessive speculative net short position limits on grain are a particularly unfair situation for producers. Increased margin requirements on the other hand will discourage traders from assuming beneficial economic risk transfer.

The primary solution to the problems affecting agriculture is receiving adequate cash prices to meet production costs. Consideration of this fact draws attention to the established federal minimum wage law.

The USDA computes parity prices for farm products on a monthly basis per an act of Congress. These prices are based upon a production cost index of prices paid for supplies and services, interest, taxes, and wages. The parity prices could be used as a refer-

ence for minimum speculative selling prices that can be used competitively against the producers.

A pricing window for farm product commodity futures trading that is referenced to parity will meet a regulatory objective to control adverse speculative trading by limiting maximum prices for buying speculative contracts and by limiting minimum prices for selling speculative contracts. The price window can be defined as covering a price range such as between 90 and 110 percent of parity. This will allow a 20 percent range of food and fiber commodity prices in which speculators can buy and sell, as well as any price below 90 percent at which they can buy, and any price above 110 percent at which they can sell.

There would be no price restriction on liquidation of positions. Thereby, the majority of the speculative trading range that is beneficial to assuming risk transfer will not be affected. Restrictions will apply only to speculative trades adverse to protection of producer and consumer prices. Professional speculators are adaptable to trading rules and they could with this rule also derive protection along with producers and consumers from adverse trades initiated by corporate price maneuvers.

Through qualified hedging accounts, the processors and exporters could still contract to buy at prices above 110 percent of parity if necessary to assure a supply and producers could still hedge or contract to sell at prices below 90 percent of parity, and probably will, if production is not controlled. A true supply and demand reaction can thus develop for the purpose of establishing a valid price discovery.

I thank this subcommittee for this opportunity to propose a constructive legislated futures trading rule for grain, oilseed, fiber, and livestock commodities produced by American agriculture.

Mr. JONES of Tennessee. Thank you very much, Mr. Eret, and if you will wait, we will question you when we are finished with the other witnesses.

Our next witness is William Mullins, National Corn Growers Association, Des Moines, Iowa.

Welcome, Mr. Mullins. We appreciate your being here.

**STATEMENT OF WILLIAM MULLINS, VICE PRESIDENT,
NATIONAL CORN GROWERS ASSOCIATION, DES MOINES, IOWA**

Mr. MULLINS. Thank you, Mr. Chairman and committee, for this opportunity. My name is Bill Mullins. I am a corn farmer from about 65 miles west of Chicago, and also serve as vice president of the National Corn Growers Association.

I had an interesting or a thought-provoking situation on the way out here today. The fellow next to me asked me what I did. I told him I was a farmer.

He said, "Well, you don't look like a farmer."

And I said, "Well, what does a farmer look like?"

He thought, "Well, that is a good point."

I said, "What do I look like?"

He said, "You look more like a businessman."

I said, "I hope I am a businessman. I have seen where the average farmer has roughly \$500,000 invested per employee. And IBM and Xerox and some of the other companies have \$50,000 or

\$60,000, so I hope we are astute businessmen and able to handle that kind of finance."

He said, "Do you go out on a tractor and do that kind of work?"

I said, "Yes; I have a brother-in-law that is primarily responsible for that and I do the financial management and the marketing for our operation."

This was kind of thought provoking, because it fit right in with what I am going to discuss today, three areas. One is the growing need for farmers to participate in the grain futures market, and how small futures commission merchants or FCM's can best assist in this market participation. And third, whether Congress should authorize the Federal Government to control margins on commodity futures contracts.

It has been said recently that the grain futures markets—wheat, corn, oats, soybeans, soybean oil, soybean meal—have never been more essential to the grain marketing programs of farmers, country grain elevators, merchandisers, and exporters than they are now. For example, a well-managed hedging program provides a form of insurance against declines in the cash prices that elevators pay for grain, and also affords a good deal of flexibility in marketing.

Simply, hedging offers protection against the adversity of the marketplace, and enables participants to take advantage of basis differentials. Basis is the difference between the local cash price and the Chicago Board of Trade future price.

With inflation and world demand for grain on the rise, prices for crops have fluctuated tremendously, making hedging in the marketplace more essential. Added to these factors are higher transportation costs and the effect that volatile interest rates have had on storage, borrowing for new loans, outstanding loans, just to name a few.

This list could go on and on. But suffice to say that it is indeed crucial to grain market participants to be able to transfer the risk of doing business.

I want to focus on the farmer, and the role that the FCM plays in his participation in the market. By definition, an FCM is an individual who is registered both with the Commodity Futures Trading Commission and with an individual commodity futures exchange to solicit and handle commodity customer business for his firm.

From my role, I have found that the FCM who is located in a small town, outlying area, is indispensable in educating the farmer about the futures market and how to effectively use the same.

Having a broker in one's local community would provide a much better service to the producer. For the most part, farmers are not educated in using futures today, and are afraid of the market, and also afraid of brokers' advice. I feel if they could have somebody right in their community, they could be better educated and better use this tool that is available for them.

However, it would appear that some of the actions that the Federal regulatory agency of the futures industry, the Commodity Futures Trading Commission, is considering is discouraging the development of small, outlying FCM offices. A few years ago, it cost

approximately \$25,000 to establish such an office; today that start-up equity has quadrupled to \$100,000

It would seem to me to be possible for a smaller business to have a different, yet equally effective, set of regulatory requirements than are demanded of larger firms. The smaller FCM firms just do not have the personnel to do the paperwork that is demanded now. And we feel such requirements are above and beyond those which are needed to fully protect the customer.

We feel that normal good practices and bookkeeping required of the FCM is sufficient. The National Corn Growers Association fully agrees that CFTC regulations must protect the consumer and the customer of the FCM. But times are changing, and the need for farmers' participation in the market has intensified. These producers can best be served, not by the major brokerage firms in metropolitan areas like Chicago, but by smaller, more personal ones in closer proximity to the producer.

But the costs of doing business for these small FCM's, as well as the economic burden placed on them by the paperwork required appears to be stifling the development and existence of these smaller companies at a time when they are most needed.

Last, I am very much opposed to Congress authorizing the Federal Government to control margins on the commodity futures contracts. It is best to leave the control of margins to the people that are most knowledgeable about the business. This is currently the commodity exchange officials and the margin committees in the respective exchanges. They have the expertise to know what the consequences of over-regulation would be. Commodity business is their livelihood, and they are going to do everything possible to keep it a good and healthy business.

Governmental control would probably set margin requirements too high by being overprotective. This would make it uneconomical at today's high interest rates to borrow money for margins and thus destroy the hedging system as we use it today. Many grain companies would have a cash flow slow-payment policy because the majority of the banks lending money to grain companies require a hedged position before funds are released.

An example of this would be a farmer selling to a local elevator, and for some reason either the river is frozen, the roads are posted, there is a backlog of shipments or whatever, that this elevator cannot deliver the grain. If he cannot find it feasible to hedge it, the bank is not going to loan him money on an open position, and therefore the farmer will sit with no payment until this grain is delivered.

Another negative effect of high margin rates would be to drive the speculator out of the market. The speculator is the person that gives the market liquidity and makes it a useful tool for the farmer, local elevator, processor, and others using the market for their hedging and risk protection for their businesses. Speculators are the people that assume the risk on the other side of the transaction.

In summary, we feel the commodity futures markets operate effectively and efficiently regulated with adequate protection under current regulations. We encourage this committee to leave the

margin decisions to the margin committees of the respective exchanges.

I thank you for your attention.

Mr. JONES of Tennessee. Thank you very much, Mr. Mullins. We appreciate your time and your interest and hope that you will stick around until we have finished with the witnesses.

Our next witness is Mr. Linly Stum of Towner, Colo.

Congressman Kogovsek was supposed to be here to introduce you, Mr. Stum, but since I already had a visit with you this morning, I am glad to know you are here and that you are a farmer and are intensely interested in our hearings, so you may proceed.

**STATEMENT OF LINLY STUM, PRESIDENT, THUNDERBIRD
LIVESTOCK & LAND, INC., TOWNER, COLO.**

Mr. STUM. Thank you, Mr. Chairman.

If I might ask that my prepared statement and the accompanying memorandum from the Colorado Attorney General's Office be submitted to the record, then I would like to just visit with you separate from the official statement.

Mr. JONES of Tennessee. Without objection, the statement will become part of the record and we will be pleased to have you narrate.

Mr. STUM. Thank you, Mr. Chairman.

I am here because even though the silver market triggered this series of hearings, the commodity trading across the board has such a tremendous effect on the producers, the bottom line, the end result of any action by this committee will be borne by the people who produce either agriculture commodities, minerals, or whatever it might be that they are trading, and it is essential that good decisions are made by this committee to my business.

I would like to depart slightly from agriculture. Well, it is related because I am extremely concerned in the trade that has developed in interest rates. The business that I am part of pays over \$1,000 a day in interest, and I am deeply concerned that when the trade in financial futures gets to a certain volume that we are liable to be subjected to a fluctuating interest rate like we are in livestock and grain, and that would be something that we could not bear, so I am very much concerned in that particular area.

Speculation is defended for good reason, and there is nobody that is any more a speculator than we are in our business. Housing development could not function without speculation. The American system could not function without speculation, but there is a difference in speculators, and due to the fact that agriculture producers are sellers, the speculative short sale is in direct competition with him, and the market must absorb without any distinction between the two, and what we are subjected to in agricultural commodities would be like me driving down the street, picking out a condominium and saying, "I believe I will just sell that today," because what we have—until it is changed—we have third person pricing in agricultural commodities that is not related to either the production or the consumption end, and somehow, some way, the system has got to work, and we have got to bring third party pricing under control, and that doesn't mean eliminating the speculator any

more than the speculator is eliminated on the New York Stock Exchange.

Concerning hedging, we hedge, and I have to admit we have also speculated to quite a little extent, but there are probably a few astute hedgers that can make it work for them, but I can tell you how it works in our area.

A bank never puts any pressure on a hedger to lift his position when he is on the winning side, when it is up, but what happens is that when the producer is making large margin calls, sooner or later if the market keeps moving in that direction, the banker calls him up and says, "We are not going to make any more margin calls for you," so I think if you will check the record, you will find that most hedging is lifted on the loss side and sometimes it is an extreme loss, and when you have a market fluctuating like we have had for the last 6 or 8 years in livestock and grain, the statistical fact that 7 out of 10 contracts lost applies to hedgers also, it isn't long before you have got the hedger back out of the market. He takes his losses about so many times, and he doesn't enter it again.

So far as educating the producer to hedge, I am not sure that that is exactly the answer.

Mr. Vernon of the Kansas City Board of Trade admitted here in this room that they spend millions of dollars educating producers, so I really don't think that is the answer.

The trade claims that futures reflects cash. That is blowing smoke. We sell grain direct for export. We ship it straight to Houston, to an exporter. It goes straight on a boat and I don't even have to ask him what he is paying for wheat that particular day. All I have got to do is find out what the basis is that day, and add it on to the Kansas City, and I have got my price.

What happens in Kansas City sets price, period. Anybody that tells you something different is blowing smoke.

In cattle, cattle is the only place where there is a semblance of a cash market separate from the futures. It is because you still have in the country thousands and thousands of local auction markets, which tends to give a cash market to cattle, but I have a computer study by a university that shows the futures leads cash prices in livestock. Also a study done by Colorado State University shows the same thing, and bringing that back home to people who produce cattle, which we do, I can tell you this: That when we buy cattle, we have got one eye looking at the cattle and we have got the other eye looking at Chicago, and when we sell cattle we do the same thing.

We don't even offer cattle on a day that the market is down, but we offer cattle on a day that the market is up. In other words, it is a tremendous influence.

In a business like ours, with the control of cattle that we have, a limit move in livestock costs us \$32,000 a day if it moves the limit one way or the other, or we pick up that much. It is such a volatile market that it makes our business very, very difficult.

I would like to read to you a letter that I received from Irving Eisenberg. He was a former broker from Merrill Lynch, worked on the floor in Chicago. He operates a private commodity advisory service at this time.

DEAR MR. STUM: At the outset, I wish to point out once again that it has been my contention ever since 1972 that the large scale speculative trade which has developed on the Chicago Board of Trade has resulted in unreasonable day-to-day price fluctuations and unusually large discounts being paid to farmers for grain.

I believe a reduction in the total speculative position limit by either an individual or firm would, in the long run, eliminate a good deal of the wild price gyrations and thereby provide farmers a fair market price for their grains as well as livestock.

If farmers are ever going to obtain a fair price, they are going to have to convince either the CFTC or Congress of the necessity in reducing speculative position limits. To do this will require expert testimony.

Then he goes on from there. I agree with this. From what I have been able to observe in the years that I have been in the business, I agree with that 100 percent. He was a trader for 30 years up to this point, he told me on the phone the other night. I think he probably knows it from that side.

What we have at this time is a CFTC except for one that is like the fox guarding the henhouse, and by allowing the exchanges to make their own rules to me makes no sense at all. It is beyond comprehension, and until we get a CFTC that intends to abide by the intent of Congress, the \$2 trillion or close to it futures trading industry still has the potential of doing to all of agriculture what happened in silver.

I would call your attention to I believe it is the fourth paragraph, page 5 of the Attorney General's memorandum, which alludes to the intent of Congress in the commodity trading industry. What we have now has evolved into something that is far removed from what was originally intended, and I think the Nation has got to get us back to that position.

Thank you.

[The prepared statement of Mr. Stum follows. The memorandum referred to is held in the subcommittee file.]

Statement of
 Linly R. Stum
 Towner, Colorado 81080
 before
 House Agriculture Subcommittee
 on Conservation and Credit
 May 21 - 22, 1980

Mr. Chairman and all members of the committee--

I am Linly Stum, President of Thunderbird livestock and Land, Inc., a feeder cattle and wheat production business located in Colorado and Kansas. (This is a non-profit organization--it wasn't planned that way, but that is how it's working out.)

I am President of Kiowa County Farm Bureau, member of Rocky Mountain Farmers Union and Colorado Association of Wheat Growers, and Chairman of Colorado Task Force on Marketing.

This last group was commissioned by Governor Lamm and former Commissioner Goulding to study marketing in depth. It is comprised of one member from each of the major farm organizations and one at large member. I would like to mention that Chairman Jones suggested a group similar to this on a national level the last time I appeared before this committee.

The reason I requested the opportunity to present testimony is that actions by the CFTC and this committee will have its most profound effect on the producers of the basic commodities.

I would think that Congress would be getting very tired of continually having to deal with an "agriculture problem". I tell you as a producer with considerable commodity trading experience that the problems will only increase until excessive speculation is brought under control.

I ask you to keep the producers of the basic commodities first and foremost in mind when considering testimony presented at these hearings for the following reasons:

- I. The producer has a 100% investment, not the small margin of a speculator.
- II. Removal of natural resources and agriculture are the only sources of new wealth to a nations economy.
- III. The value of this basic production is established by third parties with no real interest in the commodities produced or its use. This is because speculation far exceeds the volume of hedge trading--in some cases, 98% speculation and 2% hedge.

IV. The value to the producer is the only price that can have any great value to the economy, balance of payments, etc., because beyond this point, marketing charges are relatively fixed and are pass through charges.

V. The greatest effect of wide fluctuating prices, be they high or low, is on the shoulders of the producer.

Speculative volume enters the market through speculative short selling and this generally has a negative effect on producer prices and the nations economy.

Therefore, I make the following recommendations:

A. The CFTC has authority under existing law to hold speculative short selling at any level down to zero. Congress should bring extreme pressure on the CFTC to carry out the intent of Congress contained in Section 4a. and 6a. of the CFTC Act.

B. Restrict long side speculation with a graduated margin scale--any increase in the number of contracts held would result in an increase in the margin percent per contract. (This would place large speculators in a position of being more equal to the producers that have 100% invested.

C. Mandate through legislation that a bonafide agriculture producer serve on the CFTC--not an individual who happens to own some farm land, looks like a producer, smells like a producer, and is well coached by the boards of trade.

I ask that this testimony and the accompanying memorandum from the Colorado Attorney Generals Office be included in the record. I also ask that the Department of Law memorandum be given this committees careful consideration.

In closing, I tell you that you are looking at the one issue that can do more to improve the economic condition of agriculture than all of the "band-aid" solutions coming from the Administration or USDA.

Thank you for your consideration.

Mr. JONES of Tennessee. Thank you, Mr. Stum. We will be back for questioning shortly.

I recognize Congressman Glickman, a member of the subcommittee, for the purpose of an introduction.

Mr. GLICKMAN. Mr. Chairman, I would like to welcome to the committee Mr. Doug Wildin from Reno County, Kans., which is in my district.

Mr. Wildin is a businessman, farmer, rancher, but more than that he is a gentleman, since I first came to Congress, who has persisted in his interest in the operation of the futures markets.

He is one of the few people I have ever met who has what I consider to be an indepth understanding of the operation of the futures markets, both as a participant in them and as a farmer/rancher and businessman.

So it is a pleasure to have you here today.

**STATEMENT OF DOUG WILDIN, FARMER/RANCHER/
BUSINESSMAN, HUTCHINSON, KANS.**

Mr. WILDIN. Thank you.

I appreciate very much the opportunity to speak to this committee on the problem that producers have with the futures trading under the current trading rules.

I farm in partnership with our oldest son. In size our livestock and grain farming operation is in the top 20 percent in our county and is considered a family sized operation.

I am also a real estate broker and sell large farms and ranches over the western half of the United States in partnership with our middle son.

I might add that with the grain and livestock prices at only 60 percent of parity, it turns out that I farm for a hobby, and I sell ranches for a living.

We have heard the commodity trade tell us how great futures trading is for them and they try to tell us how great it is for grain and livestock producers.

However, I would like to explain why the system under current trading rules is highly unfair and inequitable for producers. To say it more plainly, futures trading is a bummer for producers under existing conditions. I will elaborate on this a little further along.

In addition to the dry wheatland we farm, our operation includes 1,000 acres of irrigated land and 500 head or more of cattle, which means we have to borrow hundreds of thousands of dollars each year as operating capital.

Therefore, we have to prepare a cash flow statement for our banker in order to borrow the large sums of money we need to operate on.

The difficulty we have with preparing a cash flow statement is that we have no way of predicting what kind of a price we may expect for our grain or livestock with the wildly fluctuating futures markets we have.

An example of these wildly fluctuating prices is the graph attached to the back of this testimony.

This graph shows the prices of February 1980 feed cattle on the futures markets to have dropped approximately \$11 per hundred-weight from July 10, 1979, to August 6, then back up \$15 per

hundredweight from August 6 to October 1; then right back down nearly \$10 per hundredweight by October 15.

We all know there is something seriously wrong with a pricing system that moves up and down way beyond what actual supply dictates; in other words, it was impossible for the actual supply of February 1980 feed cattle to have changed anywhere in proportion to the changes that took place in the futures prices in the 95-day period from July 10 to October 15.

Since the price we receive for our feed cattle closely parallels the futures prices, it is easy to see from this graph why producers can't predict within many, many dollars per head of what they will have to take for their cattle at a given time.

In preparing a cash flow statement, we know about what our costs will be. However, our selling prices may be anywhere, depending on what rumor a bunch of gamblers may have heard that will affect the way they buy or sell on a given day.

Which brings me to another point: Under current trading rules, during any trading day it is perfectly legal for anyone to sell grain or livestock they don't even own to begin with, and at prices the actual owner never agreed to take.

However, grain and livestock producers provide all the costs of production, some \$100 billion in 1978, and all the investment in land, livestock and production facilities, some \$800 billion at the present time.

While it is true that the speculator that sells grain or livestock he doesn't own has to buy it back eventually, he can simply roll over—buy back his contract and sell another at the same time—and put off buying back his contract until after the producer has to sell his commodity to pay his bills.

Furthermore, the sale of the commodity he didn't own to begin with is a major reason for excess fluctuation in commodity prices.

I would like to point out that not only are grain and livestock producers concerned about roller-coaster commodity prices, others that observe the industry are commenting on this fact.

For example, *Livestock Weekly*, San Angelo, Tex., January 17, 1980, issue, makes the following statement:

The most painful thing about the cattle market during 1979 was not the prices themselves, but simply their great volatility, their tendency to jump too high too quickly or fall too far too fast.

Often there seemed little or no plausible justification for these sharp price rises and declines in terms of numbers of cattle. The market seemed always to be in a state of over-reaction for the better or the worse. Through the year they seemed always headed straight up or straight down.

Mr. Bert Hawkins, past president of the Oregon Cattlemen's Association and a cattle industry leader, made the following statement in the May 9, 1980, issue of "Better Beef Bulletin": "Speculator influence causes volatility and instability in our market."

Mr. Hawkins also quotes Dr. Mark Powers, former professor of economics at South Dakota State University, "One of the recurring arguments made against futures markets is that, by encouraging or facilitating speculation, they give rise to price instability."

Dr. Ray Sammons, economist with Texas Ag Extension Service was recently quoted as saying, "We are living in a time of volatile markets. We see more change occasionally in 3 weeks than we used to see in a year."

Commodity trading volume is currently six or seven times greater than it was 10 years ago. During that same period of time, the increase in the fluctuations in our grain and livestock prices nearly parallels the increase in trading volume.

The question is, Who benefits from these yo-yo markets? Certainly neither producers nor consumers do. On the other hand, since it increases their trading volume and commissions, brokerage firms and boards of trade love yo-yo markets.

It may well be that a lot of our problems with highly unstable markets is the influence the boards of trade and commodity firms exert on the CFTC. One CFTC board member is a past chairman of the CBOT yet there is not a single knowledgeable grain or livestock producer on the CFTC board.

It is my understanding that at least one of our major farm organizations is taking steps to stop a major part of excessive speculation in our grain and livestock markets by petitioning the CFTC to make it illegal for anyone to sell futures contracts at prices below 90 percent of parity unless they own a like amount of said commodity or have production facilities capable of producing said commodity.

After all, why should anyone be allowed to sell anything they don't own to begin with?

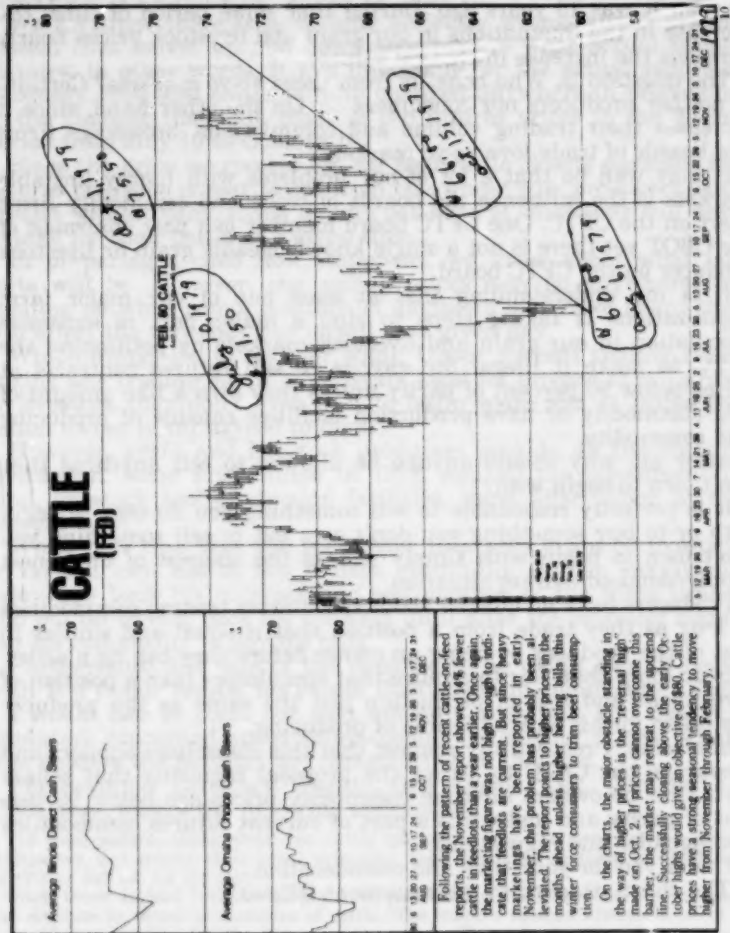
It is perfectly reasonable to sell something you do own to begin with or to buy something you don't own but to sell something you don't own to begin with simply wrecks the concept of an honest supply/demand market situation.

Producers have no qualms about speculators trading commodities as long as they trade from a position that is equal and similar to that of the producer by being an owner before they can be a seller. It is no more than fair to require that speculators take a position of investment and cost of production just the same as the producer has taken for his entire lifetime of producing.

In closing, I respectfully request that this committee support and encourage the CFTC to accept the proposal requiring that sellers must first be owners anytime commodity prices are below 90 percent of parity and make this a part of current futures commodities trading rules and regulations.

Thank you for your time and consideration.

[The chart attached to the statement follows:]



Mr. JONES of Tennessee. Thank you, Mr. Wildin, for a good statement and we appreciate your being here. I believe if the subcommittee doesn't object, that we could have one of the afternoon witnesses also heard this morning.

Mr. Walter Frankland is here, and he is willing to testify. If there is no objection, we will have him and I think we will have sufficient time for questioning.

Mr. Frankland, if you will come to the front.

Mr. WAMPLER. Mr. Chairman while we are waiting for distribution of Mr. Frankland's testimony, I would like to take this opportunity to present him to the committee. He is not a constituent of mine. He is a fellow Virginian.

In addition to being very knowledgeable on the subject matter on which he will testify, he probably is involved in the governmental process at the most sensitive level. He serves as chairman of the Arlington County Board. He is really at that eyeball to eyeball level of government and we appreciate his presence here.

Mr. JONES of Tennessee. Thank you very much, Mr. Wampler, and may I also say that Walter Frankland is from my congressional district. His home is there and his parents live there. I have known Walter for a long, long time.

At the beginning I did not mention the fact that we have Congressman Neal Smith with us this morning, a former member of the Agriculture Committee, but now a member of the Appropriations Committee, and one who has been intensely interested in all that this committee does. He is engaged in agriculture himself to a very large degree.

Neal, when the questioning comes after the subcommittee has had its round, we will also give you an opportunity to make some observations.

Thank you, Bill Wampler, for the introduction.

Mr. Frankland, we are ready when you are.

STATEMENT OF WALTER L. FRANKLAND, JR., EXECUTIVE VICE PRESIDENT, SILVER USERS ASSOCIATION

Mr. FRANKLAND. Thank you, Mr. Chairman and Congressman Wampler. I think I ought to quit while I am ahead.

Before getting into my testimony, I would like to sort of alert the committee, the subcommittee members, that they might find that our remarks are in the nature of a minority side. The more I hear from the testimony yesterday and today, I get the feeling that we get much more in the minority as we go.

We come the closest to being those who represent the consumer or the consumer's view on the issues before the committee.

Mr. Chairman and members of the committee, I am Walter L. Frankland, Jr., executive vice president of the Silver Users Association, a group with which I have been associated for 14 years.

This subcommittee is to be commended for the concern it has shown in the problems which have resulted from the speculative excesses in the silver market. These hearings demonstrate a continuing interest in those matters. On behalf of the members of the Silver Users Association, I want to thank you for the opportunity to express the views of the association concerning recent happenings in the silver market.

I would try and summarize most of my testimony by just skipping a little bit, by saying that our membership consumes about 80 percent of the silver used annually by the domestic industry in the photographic, electronic, chemical, commemorative arts, silverware and jewelry industries, producers of semifabricated and industrial products, and mirror manufacturers.

We try to keep the industry and the public as up to date as we can on the happenings in the silver market.

With regard to the CFTC, when the original legislation was proposed, we did testify in support of that commission. We did so again before the subcommittee, this subcommittee, during the reauthorization hearing in 1978.

We had become convinced that the degree of self-regulation by the exchanges in silver trading had been less than needed to protect the market against possible manipulation and that monitoring the market at the Federal level was required. Since the creation of the Commission, we have worked closely with the Commissioners and the staff at the CFTC in an effort to keep that body updated on market conditions affecting the users of silver.

In 1977 we also testified before that Commission in support of speculative limits. The Commission did not choose to impose speculative limits in the case of silver and the world commodities. However, later they did approve last year both for the CBOT and the Comex, the adoption of speculative limits, and we were in agreement with those proposals.

About a year ago, as the silver market began to heat up, and here I would like to emphasize the point, Mr. Chairman. Most attention has been focused so far on the activities between August of 1979 and March of 1980. I think subcommittee members should be aware that large positions in silver were already in place by August. Silver prices had tripled by October 1, after a 16-percent increase in 1978, and another 10 percent increase by January of 1979 over the average price in 1978.

So about a year ago, as this market began to heat up, it became apparent to our members that the increase of speculative participation in the silver market was probably placing undue upward pressure on silver prices no longer reflecting the industrial supply and demand conditions for silver.

We believed that the relatively small amount of money needed to participate in the market was creating an artificial demand situation which was not in the best interests of the users and the consumers of silver.

For several months, it was possible to trade silver contracts with margin requirements of 3 or 4 percent. Since the CFTC is prohibited by current law from establishing margins except after declaring an emergency, we requested the Comex to address the problem.

On two occasions in the first half of the year, slight increases in margin requirements were made. Each time there was an accompanying reduction in trading activity and the price rise slowed and even turned downward for brief periods.

As we look back to the situation in silver trading, especially during the last half of last year, reasonable limits on speculative holdings in combination with higher margin requirements of 10 or

15 percent might have prevented the delivery difficulties which later developed as a problem facing the two exchanges.

When the market first seemed to be out of control last year, we believe it would have been appropriate on an emergency basis to have imposed limits on speculative positions and to have required investors to come down to those limits by restricting trading to liquidation only.

We believe it important to note here, Mr. Chairman, that the directors of the major exchanges came to the same conclusion; however, they were somewhat tardy in doing so.

It is probably of little value to dwell on what should have been done. Instead, perhaps we should concentrate on the current situation. The restrictions which have been imposed by the two exchanges seem to have been effective in taking a major portion of speculative excesses out of futures trading. If these restrictions, altered as needed to provide adequate liquidity, remain in effect, perhaps trading conditions could become more normal. Certainly the pressure on the market for delivery from the exchange will continue to be lessened.

As one looks back at the impact which the new restrictions had on speculative activity and the price levels as well, it must at least cross our minds that excessive speculative activity has probably been a major contributor to unhealthy business conditions not only in the futures market, but also more importantly in the manufacturing businesses which use the material traded on these exchanges.

On January 21, when the restrictions were announced, the price for silver reached a record \$52 in Chicago. That same day the market closed at \$44 in New York after having traded as low as \$37. The next day the price dropped to \$34 in New York.

As painful as it may have been for some who were then speculating in silver and other precious metals using the leverage inherent in the futures market, the consequences, in part, had been higher price levels which had caused real hardship on manufacturers using silver. At least one plant was closed. Others shut down sterling operations. Workers were furloughed by the companies in the sterling ware business. Pricing and marketing patterns have become a shambles in all sectors of the silver-using industries to the detriment of the economy. Confusion and uncertainty dominated the business community where silver plays an important role. This confusion remains even today.

I might add, Mr. Chairman, that other commodities and sectors of the economy have evidenced the spill-over effect of speculative excesses in silver. I speak of the copper market and sugar market as two examples.

The cumulative effect of the speculatively induced higher prices in precious metals has been inflationary at a time when the Government is working to fight inflation.

We believe that it would be in the best interests of silver users and consumers of silver-bearing products for reasonable restrictions to remain in place in the hope that the forces of supply and demand could bring about more normal conditions.

We recognize as essential the participation of speculators in silver futures to permit the conduct of a viable hedging market for

use by producers and users of the metal. This entails a delicate balance between regulations and liquidity in the futures market. We are most concerned, Mr. Chairman, that a failure to maintain reasonable restraints in the futures market could lead to other rounds of speculative spirals.

The SUA Executive Committee is studying the testimony which has been presented in other forums. Likewise, the committee is reviewing the reports of the CBT, Comex and CFTC. At this time the SUA Executive Committee supports placing limits on speculative positions. The CFTC currently has this authority.

Additionally, SUA's Executive Committee believes the power to set margin requirements for commodity trading should be granted to the CFTC. Currently by law this tool is restricted to declared emergencies. We recommend an amendment to the CFTC Act which would extend this authority so that the CFTC does not have to declare an emergency to set margin requirements.

We make this recommendation somewhat reluctantly, but we believe that self-regulation during the silver crisis was not sufficient to avoid having legitimate manufacturing businesses and the consumer put through a wringer while the speculative rocket took off, realizing that during this speculative spiral, bubble or whatever you want to call it, the price of silver actually increased to a level of eight times what it had been in the beginning of the year.

I might add that because of their serious disagreement with this position, the officials at the Comex have agreed to and will be meeting with our Executive Committee to examine more mutually acceptable solutions to the problem.

After studying the current situation further, SUA may wish to come back with other recommendations that could be additional amendments to the CFTC Act.

Again, Mr. Chairman, we do appreciate being asked to come before you today. This completes my remarks, and I would be glad to stick around, too, to answer any questions if I can.

Mr. JONES of Tennessee. Thank you very much, Mr. Frankland. We do want you to remain at the desk.

Those who have removed themselves, if you will come back, we will start the questioning. Mr. Sibbet, Mr. Walsh, Mr. Eret, Mr. Mullins, Mr. Stum, and Mr. Wildin.

The subcommittee will be limited to 5 minutes each for questioning to begin with, and then if we have more questions at the end of the first round, and we have the time, we will try again.

Mr. Walsh, I have a question or two for you that I want to ask. You made some serious allegations as to the conflict of interests at the Comex with regard to actions taken on the silver market. Do you have any evidence to provide the committee to substantiate these allegations?

Mr. WALSH. Mr. Chairman, my allegations were in the form of questions. I think we need to get a clear picture of what precisely happened here, and if one reviews the Wall Street Journal over the past 3 months, the questions that prompted me to make the statements that I made were all in that Wall Street Journal. For instance, I can remember off the top of my head that on one particular day there was a margin call at \$53 million on the short side of the market.

When a man had that type of margin call, or an organization had that type of margin call on the short side of the market, it seems to me there was a lot of pressure on the short side. If he holds that position for 3 weeks, that would be over \$800 million.

All I am saying is we know what happened on the long side of the market. We know what the Hunts' position was, but what about the short side of the market? What do we know about those pressures? And we have to know this to get a true picture of what happened here. There has been no effort up until today to find out what indeed happened, and that is all we really want to do.

Mr. JONES of Tennessee. Obviously, something has happened that you or someone else has expended a great deal of money in order to join together to sue the exchanges and the CFTC. Is that true or not?

Mr. WALSH. We are in the process.

Mr. JONES of Tennessee. Would you care to tell us who has joined with you in financing this venture?

Mr. WALSH. As I mentioned in my statement, we have approximately 1,200 people who have thus far replied to the queries that we have sent out. The queries, as I said, were developed from an ad the size of my hand in the Wall Street Journal.

So we have gathered together to investigate our rights in the situation, and I hope that one of the functions of this committee would be to give us a clear picture of precisely what did happen, and how can you give a clear picture unless we understand what happened, and we can't understand what happened unless we know what sides and who had what. And all we want to do is look at both sides of the situation. I hope that this committee addresses that particular aspect.

Mr. JONES of Tennessee. I presume you have employed attorneys, maybe a group of attorneys, are they involved in helping to finance the venture?

Mr. WALSH. Mr. Chairman, I would be very happy to introduce a couple of our attorneys who are representing and investigating our rights here today and maybe you can ask that question directly to them. Mr. Marutzky is here from Chicago and Mr. Hinchey from Salem, Mass.

Mr. JONES of Tennessee. Gentlemen, can you briefly tell us if you have money in this venture, are you helping to finance it in any way?

Mr. MARUTZKY. I am Bill Marutzky, an attorney practicing in Chicago. I can categorically state to date no, I have not used any of my own funds nor has my firm used any of its own funds to finance this venture. We have been retained by Mr. Walsh, as well as other people on a fee basis only to investigate their rights.

I have brought a prior action in the Chicago district court for a plaintiff named Severin Pirot. That action was dismissed. We were paid by him for that action.

I have not, nor has my firm, nor do we intend to use our funds. We do not further tend to bring any action on a class action basis.

As Mr. Walsh stated, and I would like to inform the committee, right now we are exploring the rights that may belie this group of people who have lost money. No suit has been brought on behalf of this group by myself or my firm or any lawyers I am connected

with, and we tend to make a thorough investigation before we could advise our clients whether they have any rights in the court.

Mr. JONES of Tennessee. Does the other gentleman with the other law firm wish to make a statement? Please be as brief as you can.

Mr. HINCHEY. I am Christopher Hinchey of Salem, Mass. I have the same statement as Mr. Marutzky. We have not been involved in financing this investigation or litigation in any way. Everything has been paid for, all expenses and fees paid for by Mr. Walsh. We have no personal losses in any of these markets. We are engaged solely as attorneys. There is no personal interest.

Mr. JONES of Tennessee. Thank you very much.

Mr. Walsh, will you return for just one other question? Have the Hunt brothers advanced either directly or indirectly any money in this group action suit?

Mr. WALSH. No, sir, I wish they would though.

Mr. JONES of Tennessee. Have you talked to them?

Mr. WALSH. No, I have not. I have talked with their attorneys.

Mr. JONES of Tennessee. Thank you very much. My time has expired. I yield to Mr. Glickman for 5 minutes.

Mr. GLICKMAN. I want to thank you for the expert testimony and as I have a lot of questions, I would appreciate your keeping the answers to a minimum as much as possible.

Mr. Frankland, I want to thank you for your testimony. It was excellent. I gather from your statement there is implicit endorsement of my legislation, H.R. 7183, which would provide the CFTC with standby authority to set margin requirements under certain circumstance. While I don't expect you to endorse all the specifics of the bill, is it a fair statement you endorse the general concept of the legislation?

Mr. FRANKLAND. That is correct.

Mr. GLICKMAN. Mr. Sibbet, are you a registered investment adviser under the Securities Act?

Mr. SIBBET. A commodity adviser.

Mr. GLICKMAN. Are you registered under the act?

Mr. SIBBET. Right.

Mr. GLICKMAN. You seem to imply that the effect of the silver situation has been to impugn the reputation of not only the Chicago Board of Trade, but perhaps the futures industry generally. Is that accurate?

Mr. SIBBET. I think some of it has spilled over generally, but it certainly has ruined the silver market. It is practically dead and I don't think it can be revived.

Mr. GLICKMAN. How about other precious metals?

Mr. SIBBET. Platinum and beryllium never had a big market.

Mr. GLICKMAN. You seem to imply there are a lot of shorts. Do you have any knowledge who is currently short?

Mr. SIBBET. Not now, because everybody is out of it. The only thing left in the futures market now, practically speaking, is spreads and straddles, and things like that. The shorts are almost entirely the members of the exchanges. There was a battle between the members of the exchanges and the Hunts and the Arabs. The public is gone. It was just a tug of war between those two groups.

Mr. GLICKMAN. Mr. Walsh asked a lot of interesting questions in his statement and I think they need to be answered. Have you had an opportunity to look at any of his questions?

Mr. SIBBET. No, but I think I can answer many of them.

Mr. GLICKMAN. What about the members of the exchanges voting back in January, for example, for liquidation only and whether those members were the same members who perhaps had large shorts themselves?

Mr. SIBBET. I am sure they were.

Mr. GLICKMAN. Do you have any independent knowledge to that effect?

Mr. SIBBET. Practically every member was caught short. Many of them earlier went bankrupt at around \$18. I am amazed they didn't put this thing on liquidating more out at \$18. Letting it go up to those heights was ridiculous. If they put it on at \$18 they could have broken it at \$13, and still have a market. But running it that high and then breaking it down destroyed the market.

Mr. GLICKMAN. Mr. Wildin, you indicate in your statement the commodity trading volume is currently six or seven times greater than it was 10 years ago. Why do you think it has increased so dramatically?

Mr. WILDIN. Well, I believe it is because you remember the Russian grain deal and our grain supplies became short, and I think that is what brought it on. At least that is about the time the volume increased. I really don't know. Maybe some of the other fellows know.

Mr. GLICKMAN. My question is, I believe you as well as Mr. Stum talk about speculative short selling and you have great worries about that and concerns about that.

Speculative short selling was permissible back as long as I have been aware, it has never been illegal, and yet you talk about the great gyrations of both futures and cash prices, and part, and I think there may be some merit to what you are saying—is perhaps there are too many people in the market who have no real interest in being in the market other than speculation. I worry if we remove speculators from the market we won't have a market any more.

I wonder if you could comment on that issue because the most frequent complaint I get from farmers anywhere is the issue of speculative short selling.

Mr. WILDIN. If the speculator is willing to assume a position of investment like we do, we have no objection to that, and why shouldn't the speculator invest in commodities in a manner similar in the stock market.

Mr. GLICKMAN. How about Mr. Stum?

Mr. STUM. A bull market is fed by speculative short positions. A buyer can't buy unless someone is willing to sell. The volume comes from the spec short. In other words, the silver market, how could it have risen to \$50 if it wasn't for a bunch of short speculators who apparently were members of the exchanges feeding it. It is fed from that short side.

Mr. GLICKMAN. It was fed from the long side, too, wasn't it?

Mr. STUM. That is where the offers were coming from. But you take out the speculative short position and you are tied to what is

deliverable, and if you are tied to what is deliverable, you can't get caught short.

Mr. GLICKMAN. What about the comments of Chairman Stone of the CFTC who said we should put margin requirements on speculative trading as some way to try to limit it, not on hedging, but speculating. How do you feel about that?

Mr. STUM. I agree. I feel that the margin requirements should be tied to the number of contracts held. The small trader, no change from now, but as you increase the number of contracts held, the greater the margin per contract that you must put up, and it would tend to put large traders in the position more equal to the people who produce it and consume it.

Mr. GLICKMAN. My time is up. I appreciate the testimony.

I might mention, Mr. Wildin's recommendation at least one member of the CFTC have some knowledge of a producer, I think, is an important subject. Yesterday I made the comment I thought the administration was being quite negligent in not appointing a fifth member of this Commission which is in utter internal disarray. I hope they consider your suggestion.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

Mr. Hance, I yield 5 minutes to you.

Mr. HANCE. My first question is to Mr. Stum.

Congressman Kogovsek, who we hold in high esteem, told me of your testimony, and he does a good job representing agriculture. I was very interested to hear from you because I am familiar with the cash market in selling cattle, and you are right, you don't sell when that market is down, everybody holds and up it goes. You do have a lot of fluctuations.

The other thing is we have fluctuations in this day and time it seems like in everything, not just agriculture commodities. I am concerned that if we put too many restrictions on that, we take the speculators out to the extent you know you take one person out of a position, you hurt the position that someone else would be taking.

One thing I would like for you and the other members to consider is electronic marketing. This is something that has been tried in my area in cotton, and has worked very well, and I think Neal Smith has been a big supporter of this possibility. Until the Agriculture Department comes up with something ranchers and cattlemen and farmers and cattle buyers would have confidence in, it won't work. But if they do, I think one of the ends we may see to these wild fluctuations would be an electronic marketing system.

Generally, would you nod your heads in agreement or disagreement? If it were acceptable and something that would be reliable, do you think that would be something that you gentlemen at the table think would be beneficial?

Mr. STUM. May I comment on that. I don't know whether this is the time to do that, but we have a meeting coming up. I am chairman of a Colorado task force on marketing set up by the Governor of Colorado. It has a board member from each of the farm groups which meets once a month to discuss these issues. We have a meeting coming up in June with the marketing development man from USDA to talk about this.

One thing that would help would be to increase the posture of the cash market. We feel like there is a possibility to do this because now the producer, when he empties his truck at the elevator, marketing is finished.

But if the machinery is there—it wouldn't even take any new legislation—but by marketing through use of warehouse receipts, say I deliver to a Bunge, and take a terminal receipt, if you could pick up the phone and call a marketing service and offer for sale these warehouse receipts, which is legal tender, then there would be another level of competitive cash marketing inserted in the market that does not exist now.

It might be a Continental or it might be Farmarco that would buy that wheat that I have warehouse receipted that has been delivered to a Bunge.

Mr. HANCE. Your group might want to look at what we have done in marketing cotton. It has really worked well.

One question to Mr. Walsh. It seems to me you did have some pretty serious accusations, that you are wanting us to conduct some pretrial discovery for you, and a lot of that is going to have to come from interrogatories or taking depositions or whatever.

I think the one thing that does bother me, if the exchange directors were voting their pocketbook, why would they let the price get to \$50 before they did anything?

Mr. WALSH. Again, I want to take exception to, I am making allegations here, because I am not, and I think, again, that the only true way you can find a remedy to a situation is to exactly know what has happened.

We know what has happened on the long side of the market. We know intensively the positions that the Hunts had. But why haven't we probed into the area on the other side of the market to get a true picture. If you are going to make any recommendations here as to what is going to come about when you have a crisis, what is necessary is to understand what the crisis is.

Mr. HANCE. You are not asking us to do the pretrial discovery for you?

Mr. WALSH. I am suggesting that you simply look at the problem from both sides in order to make a recommendation. If you don't know what was played and how it was played and the pressures that were there, you are not going to be able to come up with cogent recommendations until you know what happened.

Mr. HANCE. Any time in the market someone takes one position, then someone takes the opposite position, and we will look into that thoroughly.

Thank you.

I yield back the balance of my time.

Mr. JONES of Tennessee. Thank you, Mr. Hance.

I now yield 5 minutes to the ranking member of the subcommittee, Mr. Madigan.

Mr. MADIGAN. Mr. Chairman, let me apologize for not being here at the outset. I was required to be on the floor this morning to handle the Rock Island Railroad bill which is now, fortunately, behind us.

Mr. Mullins, you characterized this as a tug of war between the Arabs, the Hunts, and the directors of the Board of Trade.

Mr. MULLINS. Mr. Sibbet said that.

Mr. SIBBET. I said that.

Mr. MADIGAN. Did I quote you correctly?

Mr. SIBBET. Yes; you did.

Mr. MADIGAN. Were there three sides to this or were there two on the same side?

Mr. SIBBET. The Arabs and Hunts were working together, and the Board of Trade members were on the other side. The public was long gone.

Mr. MADIGAN. The allegation that you are making is that the directors of Comex and of the Board of Trade changes the rules to either protect their position or salvage their position.

Mr. SIBBET. To salvage their position. They were almost bankrupt.

Mr. MADIGAN. The Commodity Futures Trading Commission, through their Chairman, yesterday testified that they were concerned about the position of the Hunts and that they repeatedly communicated that concern to the two exchanges, the one in New York and the one in Chicago.

If you were on the governing board of one of those exchanges and you were made aware by a Government regulatory agency that certain traders held a majority of the open interest in silver futures, and if that Government regulatory agency was asking you to do something about that, would you ignore them or would you do something about it?

Mr. SIBBET. It didn't originate with the Commodity Futures Trading Commission. It originated with the members themselves. As I remarked earlier, maybe you weren't here, it should have been done at \$18 and not \$50.

The reason I am going to the Commodity Futures Trading Commission this afternoon is to show them an electronic trading system which will solve all of these problems.

But, yes, we could have easily avoided the short squeeze by simply limiting contracts. They let the Hunts accumulate 12,000 contracts.

Mr. MADIGAN. You say it should have been done at \$18 instead of \$50. What is so magic about the dollar threshold?

Mr. SIBBET. Because at \$18 some of them were still holding and the market was viable and the public was still there. At \$50 the public was long gone, there wasn't anybody there. You couldn't sell. There was no way you could liquidate that situation.

Mr. MADIGAN. Should gold be allowed to be \$650 an ounce?

Mr. SIBBET. It is not \$600, it is around \$500 now. But gold has more of the public in it and so it is not so dangerous. Right now there isn't any market in silver to speak of and it is very dangerous to go either way, with hardly any buying or selling, very little.

In fact, I think my remarks here may boost it up tomorrow, actually, move the market up by my testimony here. That is how volatile, how little trading there is, and how little it would take to do it.

Mr. MADIGAN. Other than references to newspaper stories about a possible conflict of interest on the part of the members of the exchanges, is there any other evidence of any substance that any of

you gentlemen can give to the committee to support such allegations?

Mr. SIBBET. I have the thing right here. Here are the actual rules they put out. And not only did they limit it to liquidating orders only, which has been done before—I am not objecting to that particularly, but to it not being done earlier.

The dirty part was forcing them out without delivery on a schedule. Every week they had to liquidate 25 percent. That didn't bother the Hunts, they got delivery. It bothers the little farmers like Severin Pirot, and some others lost on that.

It was the few small public speculators trying to make a long-term investment that got kicked out of the market without any silver delivery. They wanted to get delivery. You haven't seen this. This is why I am bringing it up.

Mr. MADIGAN. You did say in response to my question, that the directors of the exchanges were taking these actions in advance of the CFTC expressing any concern?

Mr. SIBBET. I think they talked together. I think it was collusion—that may be a wrong word—it was a cooperative thing. The CFTC wanted them to do this and they wanted to do it and they had meetings and they then decided to do it, but they should have done it long ago. There wouldn't have been a problem if they had followed the four suggestions I have outlined here for revising the law to avoid all of this. You wouldn't have these problems.

Mr. MADIGAN. Did you read the story about the gentleman from the Occidental Petroleum Co. going in and making, was it \$170 million?

Mr. SIBBET. He was kind of bragging, and my question is, how did he know about that?

Mr. MADIGAN. Would you have any advice for the committee as to how a person could know something like that, could have such absolutely perfect timing in a market in which he had previously not participated?

Mr. SIBBET. I suspect he was tipped off.

Mr. MADIGAN. Who would you think the tip would come from?

Mr. SIBBET. I predicted in September it would happen. I thought it would happen at \$18 and I kind of gave up on it. It was obvious it had to happen. It was a question of when. His timing was so good he almost had to be tipped off. That is my guess.

Mr. MADIGAN. May I ask one last brief question. If somebody lost \$800 million in that market, did somebody make \$800 million?

Mr. SIBBET. No; they recovered their \$800 million loss is all.

Mr. MADIGAN. So, it is the penny saved is a penny earned concept.

Mr. SIBBET. The members of the exchange were in the hole as much as the Hunts and Arabs were ahead. They were almost bankrupt. You can't blame them. When a person gets to a loss of that magnitude, they lose their morals, so they were desperate. And it was just a rescue attempt.

Mr. MADIGAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Madigan, and thank you, gentlemen.

We have a vote on the floor of the House.

I recognize Mr. Richmond for 5 minutes. Why don't you act as chairman while I am gone, Mr. Richmond, and ask your questions.

Mr. RICHMOND. Certainly, Mr. Chairman.

Mr. Walsh, you are from my hometown. I was born near Salem. I used to have the same sort of accent.

I will address my questions to both of you gentlemen. Are the users with whom you are most familiar, still trading with Comex or have they lost faith in Comex. What is their attitude toward the Comex operation?

Mr. WALSH. Not being a silver user, I suggest you ask them.

Mr. SIBBET. Comex hasn't lost the market completely, it is the Chicago Board of Trade that is dead. Comex is surviving. They are running maybe 3,000 contracts a day and possibly can be rescued. But the Comex did not force people out. Comex was more reputable than the Chicago Board. They had a penalty for not delivering of one day's limit, where the Chicago Board forced people out without penalty and that is where the dirty work was. This is why they are trading in Comex, those left.

Mr. FRANKLAND. Congressmen Richmond, the users are still in the market on a limited basis. They find it a difficult market to use for hedging purposes.

Mr. RICHMOND. They are still hedging?

Mr. FRANKLAND. Yes; but on a more limited basis than before.

Mr. RICHMOND. The silver market has settled down to between \$10 and \$15 which I assure you gentlemen feel is a reasonable price.

Mr. FRANKLAND. I certainly will be willing to make a statement to the effect that is not what I consider to be a reasonable price. It is actually twice as high as a year ago. From that standpoint I don't believe it is reasonable. The price level where it is now is much better than where it was and, of course, we never know where it may be 3 months from now. But I would object to its being classified as a reasonable price.

Mr. RICHMOND. As a practical matter, what happened to all the people who bought silver at huge prices and melted it down and what happened to the people who paid \$30 to \$40 an ounce for the silver? Did they take an enormous loss? What happened to them?

Mr. FRANKLAND. If they are hedging their operation, they probably came out all right. If they weren't, they may be stuck with some high priced silver at the moment. I am not able to report anyone who has gone out of business as a result of that drop.

Mr. RICHMOND. They were all hedging then; is that correct?

Mr. FRANKLAND. Either that or they are still suffering losses.

Mr. WALSH. I would like to add something here. We have a few refineries who have contacted me who have a little different perspective on it. A couple would be happier with the price around \$25 to \$30. A couple of them mentioned they were not able to hedge because the margins were increased and they were forced out as a result of these actions previous to January 21 and as a result they are very frustrated because as a refinery they were not able to do anything about it. It went out of their ball park, so to speak, so they were hurt financially about that and they are within our group in terms of being involved with what we are trying to find out actually did happen.

Mr. RICHMOND. So far as you know, there were no silver refineries forced to go out of business?

Mr. WALSH. No; but they have lost quite a bit of money.

Mr. RICHMOND. On the other hand, if they had used less cash to buy silver and used more cash to buy margins on the hedging, they would not have lost that money.

Mr. WALSH. They couldn't justify it according to a couple conversations I had, the increased margin requirements to be able to hedge. That forced them out. That forced them out of the market entirely because they couldn't handle the increased margin requirements. It went somewhere from a \$500 to \$5,000 spread.

Mr. RICHMOND. On the other hand, I don't think anybody at the table objects to the fact that Comex did raise the marginal requirements.

Mr. WALSH. Well, I don't know. I personally have no objections in this thing whatever. I think we have to take a good look at what happened and make recommendations.

The only way we can do that is find out what effect the margins did have and the people involved in the markets and how much they lost as a result of these increases in margins before we can have a rational judgment.

Mr. RICHMOND. Anybody in the business and who hedged in a useful, efficient fashion didn't necessarily have to lose money, Mr. Frankland said.

Mr. WALSH. That is not true.

Mr. RICHMOND. Why?

Mr. WALSH. The cost of hedging increased so radically as a result of these increases in margins that it hurt those trying to hedge.

Mr. SIBBET. May I comment.

Mr. RICHMOND. Please.

Mr. SIBBET. The height margin drove everybody out of the market except the Arabs and the Hunts. They were the only ones who could afford it.

Mr. RICHMOND. Did others keep buying silver at high prices?

Mr. SIBBET. No, I don't think so. They quit buying and hoped it would come down.

Mr. WALSH. Can I make one more quick comment here. There was a large majority of small investors in here right in there right up through the top and they got in there through—if you open the Wall Street Journal you see Monnex, First National Monetary Corp., and a number of corporations that sell small amounts of silver and gold on margin. These are the people who rode it up to the top, getting in at the top, and really ruined their future in an honest hedge against the inflationary climate trying to protect themselves. These are the bulk of the people I am here representing. The small investor was not considered in this.

Mr. RICHMOND. I have to go and vote. We will adjourn the meeting until Chairman Jones returns.

[A brief recess was taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

I apologize to the witnesses for the delay.

Before I have some more questions I am going to recognize Neal Smith, a Representative from Iowa and a former member of the committee, for some questioning for 5 minutes.

Mr. SMITH. Mr. Chairman, I appreciate your yielding to me. I really appreciate your having the hearings because I think they are very important.

The thing that intrigued me from what I heard this morning was that it seems that the attention is riveted pretty well on two things: One is increasing margins and the other is eliminating some of the speculators. I think there are some pitfalls in both of those proposals that I would like to mention and ask for comments.

As far as speculators are concerned on the cattle contract, there isn't any list anywhere that shows on each trade who is speculating and who isn't, so we don't know who all are speculators.

The other thing I want to mention about the cattle contract is that we had a study that showed only 3 percent of the people with cattle contracts were farmer-feeders. The economic purpose of the contract was for farmer-feeders, so it isn't serving its economic purpose. A big number on that contract were packers and grain companies, many of whom were short, and nobody has been able to explain to me why these packers should be on the short side to a large extent.

So what I am saying is I think the contract, until it is remodeled, can't be saved by trying to figure out some rule on speculators.

On the grain trade I want to mention this: That we have no idea what volume of speculation there is at any given time because the international grain companies, as an alleged offset to an international sale, can list large amounts as hedges. In fact, if they want to speculate, if they have some inside information they get from time to time, all they have to do is have an affiliate overseas place an order with them, and that makes the basis for a hedge. Curbing these other speculators is almost irrelevant to the whole excess speculation problem.

The big speculation is by international grain traders and until we know who has made sales to whom, we won't have the information upon which to make any judgment.

So all I want to do, Mr. Chairman, is to point out that in my judgment we would not cure these problems either by having CFTC increase margins. Indeed, if they raise the margin, it is going to hurt the small fellow more than the speculator. The speculator who has inside information can pay whatever the margin is. It is the guy who is in business trying to hedge to reduce risks, who can't pay the higher cost for an increased margin. So that is not going to help any.

I think we need greater surveillance ability down at the CFTC. We need an active commission to operate under existing law and to do the things that can be done under existing law.

One way to get at this problem of international grain companies speculating far over the announced limits is to require them to immediately report foreign sales. If they report foreign sales that appear to be phoney, people in the business will look at it and say they can't be. They will make their own judgments, and discount it. Just a matter of better information, I think, is what we need.

We had a bill that went through the House on that. We got caught in a Senate conference, and I wonder if any of you have any comments to make in response to that? In other words, we need to know more about who is making international sales and at what time. Do you have any comments on that?

Mr. SIBBET. I think that is fairly well known. It is announced in Reuters everyday about these big sales, and all of the large traders and speculators have to report what they are doing. This is summarized in a monthly publication called Commitments of Traders.

Mr. SMITH. But the trouble is there are as much as 18 days before we know about it and in that period of time you can cover the whole grain crop, you know. We need immediate information.

Mr. WILDIN. I would like to say I certainly agree with what you are saying, Mr. Smith, and I want you to know we producers have very much appreciated your diligence in probing this situation as you have for several years. I know you have had some criticism of this, but I am sure you are on the right track.

And we also appreciate, Mr. Chairman, your efforts to probe this thing and get it out in the open. We certainly need to do a lot better job of paying attention to what is going on. After all, agriculture is our most important industry in the United States and we cannot stand agriculture that is in a financial position that it is in now, and if the inequities in futures trading is causing this, we certainly need to correct it.

Mr. SMITH. I would say in closing, it seems to me that rather than do what has been suggested about margins and speculation, we would be better advised to give the CFTC more surveillance ability and to require immediate reporting of these foreign sales.

Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Neal Smith, for your being here and attending this session of the hearing.

I yield 5 minutes to the ranking member of the full Agriculture Committee, ex officio member of this committee, Mr. Wampler.

Mr. WAMPLER. Thank you, Mr. Chairman.

I want to thank all of the witnesses for their appearance here this morning and for the testimony. I think it has been most helpful.

Mr. Wildin, I was somewhat intrigued with your closing paragraph in your prepared statement in which you requested that the committee support and encourage CFTC to accept the proposal requiring that sellers must first be owners any time commodity prices are below 90 percent of parity and make this a part of current futures and commodities trading rules and regulations.

I suppose everyone on this committee would favor 90 percent of parity. Some of us believe it should be 100 percent parity, but with the present economic climate I think the likelihood of achieving 90 percent parity in commodities is unlikely. I wish I could be more optimistic, but I can't.

The question I have with that proposal is what effect would this have on driving legitimate speculators out of the market?

Mr. WILDIN. I am not sure just how to answer the question. I will say this: The purpose of limiting the short spec below 90 percent of parity would not automatically bring prices to 90 percent of parity. That will not happen I don't believe. It would simply keep the man

who didn't own the commodity to begin with from acting as though he owned the commodity and selling it at a price the actual owner didn't agree to take.

Mr. WAMPLER. Maybe it is my lack of understanding of the total function of a futures market, but if I understand it, and reduced to the simplest terms, it is for every person who chooses to hedge. On the other end of the equation you have to have someone speculate in order to provide the equilibrium so necessary.

I think every member of this committee shares the concern about when does speculation become excessive and when does it permit manipulation of the market, which I think is certainly contrary to a legitimate function of any futures market.

I just would make this general observation. I think we do have a problem here and that, of course, is the purpose of these hearings, is to try to identify what the problem is and see if, in fact, amendments to the CFTC Act are required, and if not, is there some way that CFTC under its existing authority or the exchanges themselves through selfregulation and selfdiscipline can put forth regulations that will hopefully minimize this type of thing that is happening where we do have undue speculation, or excessive speculation, or manipulation, if I can use that term.

I indicated at the hearing yesterday that I was not among the enthusiastic supporters of the original act creating the Commodity Futures Trading Commission, because I guess it is part of my feeling that all too frequently Congress attempts to address itself to a problem, but in regulation we tend to compound the problem rather than solving it. I don't want to see us overreact and do something that would cause irreparable damage to a legitimate market function, economic function, such as futures trading.

We want to be careful that in our desire to cure a problem we don't overreact as we so often attempt to do, nor do I want to see CFTC take action through their rulemaking authority under existing law that would have negative effects on the functions of the market.

Mr. WILDIN. May I make a comment?

Chairman Stone is the first member of the Commodity Futures Trading Commission to my knowledge that has ever given consideration at all to the producer, and the influence has always been from the trading side. It remains that way.

We have the chairman of the Chicago Board of Trade sitting on the CFTC Board and I don't think we can have any true appraisal of the producer side of this thing unless we have knowledgeable producer participation in the CFTC. I think the CFTC is an agency that we need and I think they have laws that they are not using at the present time.

For example, relative to short selling, part of the CFTC Act of 1936 allows them to limit or abolish speculative short selling if it becomes a burden on the market. We have tried to get a hearing and have not been able to do so. It has been turned down on an occasion or two.

Mr. WAMPLER. Let me allude in conclusion to a comment our colleague, Mr. Glickman, made this morning.

As you know, there has been a vacancy on the CFTC now for something over 12 months and it would be my hope when this

vacancy is filled, by whoever fills it, that they would give serious consideration to appointing someone as a commissioner who has some background from the production side, in the commodities or whatever it might be, so he could give meaningful input into the deliberations of the Commission.

Mr. WILDIN. It also needs to be a producer who understands how the thing works. There are few producers who actually understand how the trading works.

Mr. WAMPLER. I would say there are a lot of people who don't understand it fully, but I do think that type of input would be very helpful in the deliberations of the Commission, and in helping to build public confidence in the Commission and hopefully to get more producers to participate in futures trading. It does serve a very legitimate economic function.

Again, I want to be careful we don't do anything here that would drive legitimate speculators out of the market because unless we have that in equilibrium, I don't think the futures trading will accomplish what it was intended to.

Mr. WILDIN. Producers, grain and livestock producers, have never given permission allowing their commodities to be traded on the Board of Trade. Never at any time did we have a referendum in which we were allowed to decide whether our commodities were to be traded.

I noticed that the fertilizer industry turned down the proposal to trade anhydrous ammonia.

Mr. WAMPLER. Thank you very much.

Mr. Chairman, I apologize for transgressing on the 5 minute rule. I appreciate your comments and I want to thank all of the witnesses for the testimony here this morning.

Mr. JONES of Tennessee. Thank you very much, Mr. Wampler.

Gentlemen, I want to wind this up, and I think I will miss the vote and go ahead and ask Walter Frankland a question or two that I have since there are no other members here.

Mr. Frankland, my question is: Do all commodity exchanges operate the same way with respect to margin requirements?

Mr. FRANKLAND. In this country they do. Apparently, the exchange in London, the London Metal Exchange, does operate somewhat differently in that it doesn't have the clearinghouse set up and they use—it is more on a principal to principal basis. In the case of margins, the variations margin primarily is handled differently in that collateral can be put up instead of cash, as such, and it does not permit taking out of the cash on the other side until the expiration of the particular contract.

So in that respect it is different and it may be very well that something along this line might be in the form of a compromise situation that could be used in our markets.

I don't know whether the brokerage houses, traders and participants would buy it, but it is not a bad thing to consider because I think one of the problems we saw happening was the pyramiding effect of the silver market as it passed, well, \$9 or \$10 on up to \$50. I think a contribution to a lot of that movement was the pyramiding effect on the long side.

If we did have a system of that type, perhaps it would help mitigate some of that problem.

Mr. JONES of Tennessee. Are you saying there would be some advantage in that, if we had it that way?

Mr. FRANKLAND. In my view, it would be, yes, sir. I guess we need some more expert testimony on it, but it is something I think should be considered. I have heard that proposal as perhaps a way of changing the current situation.

Mr. JONES of Tennessee. Are the rules regarding margin variations imposed by the government or by the LME?

Mr. FRANKLAND. It is imposed by the members themselves. It is not regulated.

Mr. JONES of Tennessee. Do you feel there is any possibility that we might have some changes like that here?

Mr. FRANKLAND. I am very optimistic as a result of these hearings and other actions that some improvements can be made and I believe a change in variation margin requirements would come under the category of improvement. I would be hopeful something like this could be considered, at least by the exchanges or by the CFTC.

Mr. JONES of Tennessee. Thank you very much, Mr. Frankland.

Mr. WALSH, I have one or two I would like to ask you since I have the time and nobody is around, if you don't mind.

Would you explain your relationship with the firms that you mentioned earlier, Monnex, First National Monetary Corp., which we refer to here as leverage firms?

Mr. WALSH. I would be very happy to. I consider this relationship we have been talking about here between the Hunts and the directors—I think it has been brought up in Senator Stewart's hearings that the futures contracts held by the Hunts, quoting one of the Comex directors, I think, said it wasn't a significant position in the futures market, not particularly a significant position, estimated somewhere to be in the area between 3,000 and 5,000 lots, in that ball park area, and that was not a significant position.

My contention is the significant positions were held by the American public through Monnex, First National Monetary Corp., a number of these institutions that prey on precious metals as a legitimate and prudent hedge against an inflationary situation in our country.

And there is where you get all the people that I represent, a great percentage of them, coming in and taking their life savings, putting them in the precious metals market to save it from eroding, and being wiped out as a result of these actions.

I think you have to look at the whole picture here, and I just hope this committee will function in that area so we can really indeed see who were actually in the long side of the market and the short side of the market and what financial pressures were exerted during this period of time.

Mr. JONES of Tennessee. Do you have any other leverage firms that are involved in your operations?

Mr. WALSH. International precious metals—there are four or five. I have a list but it is not with me now. I would be happy to provide the chairman with that.

Mr. JONES of Tennessee. Would you. I would be pleased if you would.

Another question: Are they helping to pay for your investigation?

Mr. WALSH. Yes, they are.

Mr. JONES of Tennessee. If you would supply for the record any of those leverage firms, we would appreciate it very much.

I have some other questions I would like to ask, but I know the time is drawing near for the afternoon session. I think I am going to have to stop at this point.

I am going to ask unanimous consent for all members to supply some of you, if they so desire, with questions that you will answer in writing for us. If you will do that, we would appreciate it very much.

We will try to get to the real needs of what this committee should do, and we are trying our hardest to do that. I hope that you gentlemen recognize that. And I do want to also say thanks to each of you for the good testimony that has been provided us today. It has been constructive, it has been helpful, and we are certainly going to take a good look at what you recommended and what you have had to say.

You haven't had the biggest audience that we have had. We had a larger crowd yesterday. I suppose we will have a large one next Thursday, but we got to the meat of the problem today and I appreciate it very much.

The meeting stands adjourned until 1:30 this afternoon.

[Whereupon, at 12:25 p.m. the subcommittee recessed, to reconvene at 1:30 p.m. the same day.]

AFTERNOON SESSION

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will come to order.

I want to take this opportunity to welcome all the witnesses. I see that you already are in place so we will not have to have any transition of moving people from one place to another.

I would like to briefly lay down the ground rules, and we do it simply for the sake of trying to save as much time as we possibly can and at the same time be able to get the testimony that you provide us.

We will hear each of you for a period of 10 minutes, and the light in front of Dr. Yeutter determines the time. When the red light is on that means that 10 minutes are up.

If you lack just a little bit of being finished, go right ahead and finish, but if there is a great deal, I would like you to summarize it, if you can, because your entire statements will be made a part of the record.

For the subcommittee members, they understand already, but I will say to you witnesses that each subcommittee member will be allowed 5 minutes after time for questioning after all of you have finished your statements.

Is there anyone that cannot conveniently stay until we all finish?

That is fine; that is the way we have been operating, and we like to have it that way, if possible.

We are glad that you are here, and we will not keep you any longer than we possibly have to.

Mr. Madigan has arrived and is the ranking member of this subcommittee. Do you have a statement you would like to make, Mr. Madigan?

Mr. MADIGAN. Mr. Chairman, I think that I hope what will be covered is who initiated the actions that caused prices to come down.

I am not clear as to whether or not the exchange did that of their own volition or did that in response to the Commission soliciting the exchange to do that.

That will be a very important part as far as contributing to my understanding to the whole thing, and I hope that will be addressed by the witnesses this afternoon.

Mr. JONES of Tennessee. Thank you very much.

That is a good point, too, because that has not been borne out yet.

We heard one of the afternoon witnesses, Mr. Frankland, before lunch, so our first witness this afternoon is Mr. Robert Wilmouth, president of the Chicago Board of Trade, Chicago, Ill.

Mr. Wilmouth, I am delighted that you are here, and I am sure the members of the subcommittee are happy that you could make it, so you may proceed.

STATEMENT OF ROBERT WILMOUTH, PRESIDENT, CHICAGO BOARD OF TRADE, CHICAGO, ILL., ACCOMPANIED BY ALFRED H. GRUETZMACHER, CHAIRMAN, BOARD OF TRADE AND VICE PRESIDENT, GELDERMANN CO., AND JOHN STASEN, OF KIRKLAND & ELLIS, COUNSEL TO THE BOARD OF TRADE

Mr. WILMOUTH. Thank you, Mr. Chairman.

I am Robert Wilmouth, president of the Chicago Board of Trade.

Behind me and to my left is the chairman of the Chicago Board of Trade this year, Mr. Alfred Gruetzmacher, who is also vice president of Geldermann Co., futures exchange merchants.

Thank you for this invitation to testify, and I think I can shed some light on what I see as the central questions posed by these hearings.

In view of recent events, particularly in silver, is the Commodity Exchange Act adequate to protect the public interest? My answer is a firm yes, and we have prepared for the record a detailed written statement supporting our position.

My remarks are but a brief summary of that detailed statement.

During the period April 1979 through March 1980, futures prices and cash prices in both gold and silver moved in tandem; there was no systematic tendency for futures to lead cash, or cash to lead futures and silver futures markets continued to serve their price-discovery and risk-shifting functions.

Why did gold and silver rise and fall? I suggest two factors:

One, inflationary pressures, followed by unprecedented credit restrictions and extremely high interest rates, and then by a recession.

Two, changing perceptions of worldwide economic and political conditions, including the unfortunate situations in Afghanistan and Iran.

In sum, I believe that silver cash and futures prices rose and fell together and in tandem with gold, because of worldwide market fundamentals and not because of the actions of any individual or group of individuals.

This is not to say that these were easy or in any sense normal times. It is indeed unusual when a relatively small number of individuals desire to convert large amounts of paper currency to silver. The record will show that the Board of Trade, on its own initiative, took a number of self-regulatory actions during this period.

Between September 5, 1979 and March 18, 1980, silver was discussed at 15 meetings of the Board of Directors of the Exchange, 12 of which were emergency meetings. As a result of this daily surveillance and monitoring, the Board of Trade took margin or emergency action on 21 occasions. These silver actions fell into six categories.

First, we adjusted margins throughout this period.

Second, on October 25, 1979, we adopted position limits limiting market participants to 600 contracts, net long and short.

Third, on January 22, 1980, we acted to prohibit new positions in the January, February, and March contracts and directed a compulsory phased liquidation of the exiting positions in the February contract.

Fourth, during this period we expanded price trading limits several times in an effort to allow the futures to more accurately reflect the changing prices in the cash market.

Fifth, we changed trading rules relating to spread trading in an effort to improve the ability of participants to liquidate their positions in the market and to allow the market to continue to function as a hedging and price-discovery mechanism.

And sixth, when the price of silver broke sharply on March 26 we reviewed the financial positions of five of our firms continuously until they had liquidated their silver positions or no longer gave us cause for concern over their financial stability.

In essence, these steps were taken for two reasons:

One, to assure that brokerage houses and their customers had adequate financial protection during a period of extreme price volatility.

Two, to prevent large concentrations of speculative positions from being maintained in the market, or from entering the market, which the market could not reasonably accommodate because of limited deliverable supplies, changed delivery expectations, and general world economic and political conditions.

By both measures, I believe we succeeded.

Much has been said about what the CFTC should have been doing during this period. We believe the CFTC acted in a prudent and responsible manner. They recognized, as we always do in the performance of our regulatory role, that futures regulators are not in the business of setting prices. The free market does that.

There is also much talk about taking "margin" authority away from futures market professionals and giving it to a Federal agency.

In determining appropriate levels of futures margins, we must strike a delicate balance. As economists have explained time and

time again, levels must be high enough for safety, but low enough to avoid, as much as possible, impairing liquidity.

They also must not be so high as to increase the cost to hedgers, or to force them into unregulated forward contract arrangements, as Federal Reserve Chairman Volcker has repeatedly warned.

This delicate balancing in determining appropriate levels of margin is best done by experienced market professionals who have intimate knowledge of the industry and the flexibility to act promptly. A centralized government agency simply cannot do the job effectively, as Congress has repeatedly concluded after careful review.

Turning now briefly to March 1979 wheat, which is discussed in some detail in our written submission, I wish to reaffirm the testimony I gave to this committee on March 28, 1979. We did not have then, nor do we have now, any information which shows that there was an actual or threatened manipulation, corner, or squeeze, or that there was a major market disturbance.

A Federal judge so concluded on March 18, 1979, and the study prepared for this committee by Dr. Richard Heifner, as well as Dr. Roger Gray's earlier study, agree with that assessment.

At this point I must say a few words in defense of speculation, in response particularly to some of Chairman Stone's remarks yesterday. Speculation improves the efficiency of futures markets as speculators provide vital economic services to the proper functioning of the markets. They are both buyers and sellers, tempering rather than contributing to price volatility.

They use their own capital to assume a risk of adverse price changes that would otherwise go to the consumer as a middleman's cost of doing business. They only make money when they are right so they spend a lot of time and research trying to be right and are up to date on supply and demand factors, thus playing a vital role in the price-discovery process.

Speculators also provide liquidity so that hedging even in large volume may be done with minimal price effects and minimal execution costs.

As Dr. Roger Gray of Stanford University sums it up, and all other economists who have studied the issue agree:

Markets with relatively high levels of speculation are most effective for hedging and those with low levels of speculation are least effective. The chronic threat to futures trading is lack of understanding of the more subtle point that effectiveness for hedging depends upon speculation.

The subcommittee has also asked for our assessment as to whether the CFTC has sufficient authority to carry out effectively its congressional mandate of protecting the users of futures markets and the market mechanism itself. It is clear to us that the Commission has sufficient authority. It certainly has broad authority and enforcement powers with respect to contract markets.

In addition the CFTC has extraordinary power to prevent manipulation of the futures markets. This authority can be divided into four categories:

One, the CFTC has authority to bring injunctive and other enforcement action against persons manipulating or attempting to manipulate futures markets.

Two, the CFTC has the authority to set position limits on the number of futures contracts a person can hold or trade in any commodity.

Three, it has the authority to obtain detailed information from traders and brokers about both their cash and futures positions.

Four, it has authority to regulate trading by compelling futures exchanges to take CFTC-prescribed actions.

I have already mentioned the CFTC's statutory emergency powers, which the Federal Court of Appeals for the Seventh Circuit has held to be judicially unreviewable, even though both a Federal judge and now Dr. Heifner determined that the actions taken by the CFTC giving rise to the case were ill-advised.

Under this precedent, at least, the CFTC is the most powerful agency in Government.

Finally, in assessing the CFTC's powers and its actions in executing these powers, we are struck by the thought that the CFTC's energies are sometimes misdirected.

We continue to believe that if there are problems in the futures industry, they generally come not from exchanges or members of self-regulatory organizations but from other segments of the industry.

Congress is well aware, of course, of the problems that were caused by the sales practices of certain options dealers, and the problems that are currently caused by people selling a variety of products which are in reality futures contracts, but are not part of any regulatory entity or exchange. We in the exchange community have no jurisdiction or power to prevent fraud in these areas.

The public often fails, however, to make a distinction between the legitimate and regulated futures industry and the activities of unregulated and sometimes illegal operators. We applaud the recent statements of the CFTC that it is attempting to focus more manpower and attention in this area.

This concludes my summary remarks.

Thank you.

[The prepared statement of Mr. Wilmoth may be found on p. 317. The detailed statement referred to is held in the subcommittee file.]

Mr. JONES of Tennessee. Thank you very much, Mr. Wilmoth.

We will now move to the next witness, and although the bells have rung, it is possible we can proceed without having interruptions.

Our next witness is Dr. Clayton Yeutter, president of the Chicago Mercantile Exchange.

We have seen Mr. Yeutter on many occasions, when he was before the full committee and subcommittees when he was here in Government.

You may proceed.

STATEMENT OF CLAYTON YEUTTER, PRESIDENT, CHICAGO MERCANTILE EXCHANGE, CHICAGO, ILL.

Mr. YEUTTER. Thank you, Mr. Chairman, members of the subcommittee.

I wish upon my return, Mr. Chairman, that I could say that American agriculture is in as good health, economic health as it

was a few years ago but, regrettably, that is not the case, as you know.

It is a very difficult year for agricultural producers, especially for livestock producers who are among our major clientele, those who produce cattle and hogs, all of whom are suffering major financial losses today.

It has been difficult enough for producers, as you know, to attempt to adjust to the risk and uncertainty which prevails in worldwide market conditions today; that is, to the shifts in supply and demand fundamentals to adjust to the uncertainties of Government action like grain embargoes that we have experienced earlier this year.

That should be ample evidence of the need for futures markets to provide those producers an opportunity to shift some of the risk from their shoulders and that is why the proceedings that are before you today are so tremendously important to American agriculture.

I have a prepared statement, Mr. Chairman, that I will make available for the record, but I would like to speak extemporaneously from here on and talk about a number of issues, some of which are beyond the statement.

Mr. JONES of Tennessee. You may do so and the entire report will be a part of the record.

[The prepared statement of Mr. Yeutter may be found on p. 330.]

Mr. YEUTTER. Thank you, Mr. Chairman.

First of all, I would like to emphasize to the chairman and to the subcommittee that it seems to me that the Congress and the general public have both been exposed in recent weeks to a sky-is-falling syndrome.

This has occurred particularly in the aftermath of the silver situation, but whether it is due to that or to other reasons, it is apparent that a number of the witnesses that have appeared before you, or at least one of those witnesses, would like to have you believe and like to have many others believe that the fiber and the economic well-being of the Nation as a whole has been jeopardized by some of the occurrences in futures markets during recent months.

I do not share that view, Mr. Chairman, and I would like to state to the subcommittee that I do not believe it is helpful for the Chairman of the Commodity Futures Trading Commission to use words with the kind of emotional content that are incorporated in the statement that he made to you yesterday.

I would like to make specific reference to some of those and point out my misgivings and my trepidation with respect to that kind of language being used in a hearing that is designed to evaluate and provide an oversight over public policy.

One of his initial statements was that there has been massive unchecked and unnecessary speculation in commodities.

I would like to know, Mr. Chairman, how anyone in Government, including the Chairman of the CFTC, defines unnecessary speculation.

I don't believe it is possible to define unnecessary speculation in any manner that has yet been surfaced. He submits that this

speculation has been an unacceptable threat to the Nation's financial structure.

I wonder on what basis he has reached that conclusion. Is he really suggesting that we have so little resilience in the economic system of this Nation that it cannot recover from a threat to the economic well-being of four or five brokerage houses?

I find it difficult to believe that what happened in silver or almost happened in silver in any way seriously threatened the financial fabric of this Nation.

He has made continual reference to the term "gambling."

I would like to differentiate between gambling and the speculative activity that is so essential to futures markets.

Mr. Wilmouth already had some comments to that effect; but if the Chairman really believes that what is transpiring in futures markets is gambling, then I wonder about his knowledge of this industry, because I do not consider them to be analogous.

Mr. JONES of Tennessee. If you can pause for just a moment, I am going to have to go vote.

[A brief recess was taken.]

Mr. GLICKMAN. Dr. Yeutter, why don't you go ahead and I will temporarily chair until Mr. Jones gets back.

Where were you in your statement, just so I would have some idea.

Mr. YEUTTER. I am not following the prepared text.

I was commenting on some of Chairman Stone's statements of yesterday, and I will continue with that, if I may, my point being that the Chairman made some comments that I found very difficult to justify in terms of their emotional content and their accuracy as applied to this industry.

Another example to which I would make reference is his comment about unrestrained speculation. I think it has been a good many years before since speculation has been totally unrestrained in this industry. He made comments about overwhelmingly speculative markets.

I wonder what overwhelmingly speculative is, and he also alluded to the fact that over the last couple of centuries several attempted commodity corners preshadowed the general economic collapse as if to say what transpired in silver may have preshadowed another general economic collapse of this country.

As an economist, I would hope the Chairman remembers his studies of what are called spurious correlations, that is whether there is a cause and effect relationship between two events. I would consider those to be spurious correlations.

He mentioned the danger to financial institutions that allegedly occurred in the silver crisis, and the potential for disastrous ripple effects throughout the economy.

I wonder on what basis he suggested that we were heading toward disastrous ripple effects.

As I said earlier, it seems to me that the Chairman has grossly underestimated the basic economic strength of this country and the resilience thereof.

This is particularly true with respect to his comments about speculation which would seem to indicate that the price movements in silver, speculative price movements in silver, price move-

ments on the futures market were out of line with those in the cash market, and that did not happen. They moved together.

What the Chairman has really been making in his testimony in recent weeks is an argument for wage price controls in a bit different way, in a way that is a bit different from usual.

If that be his concern, then it seems to me that that argument should be made in a different forum than from one of applying margin controls to commodity trading to achieve that same objective.

I would like to concentrate a minute on the margin question. I do not wish to duplicate what Mr. Wilmouth has already said on the subject, but clearly I believe that you and everyone else on this subcommittee might now understand that there is a substantial difference between margins and securities and commodities are not the same thing.

Commodity margins are established for the purpose of preventing contractual default. They are in essence a performance bond, a function that is different from the securities industry.

There has never been a default contractually in the history of the commodities industry, and to suggest that margin authority ought to be established in some Federal agency belies the record of success in this industry in establishing margins in the past.

What is really at issue on the margin question is something that goes far beyond the traditional performance bond function of margins. What Mr. Stone has been suggesting, and what some others have been suggesting in recent weeks, is that margins perform an additional function of limiting participation in futures markets, and in particular of limiting speculation in those markets.

That is a public policy question, Mr. Chairman, that goes far beyond anything that has traditionally been discussed in this committee or seriously discussed anywhere before.

It seems to me that before the Congress legislates in that arena it ought to give an enormous amount of study and very careful evaluation to that kind of proposal.

Referring now to Chairman Stone's letter to Congressman Foley of May 16, in which he comments on H.R. 7183, in that particular letter he points out what he considers to be a commonality between margins and securities and margins and commodities by stating that each serves as a threshold determinant for a customer considering entry into the market.

That is not the function of commodity margins as we know them today. That is the function of commodity margins as he would like to see them in the future and, in my judgment, that is not a proper role for those margins.

He goes on in this letter to Congressman Foley saying that it is appropriate to limit speculative activities to a level conducive to useful commerce.

I would like some definition of what speculative activity, what level of speculative activity it is conducive to useful commerce. It seems to me that we have not yet observed a level of speculative activity that is not conducive to useful commerce.

I am not persuaded that anything other than that occurred even in the silver case.

The Chairman also suggested the need to maintain a proper balance between speculation and hedging activity, and I wonder how he or some Federal agency would determine or evaluate that proper balance. It seems to me that that is a function that would be very difficult for any Federal agency to perform, and it takes us into a regulatory arena far in excess of anything that we have considered in the past.

I would like just to emphasize in this respect too that there are tradeoffs in the establishment of margins. It is very simple, Mr. Chairman, to suggest that margins ought to be higher and that has some superficial appeal, but what one must understand is that there are not simply advantages to setting margins at a higher level.

There are also disadvantages and costs involved in that process, and those costs apply to hedges as well as to speculators, and clearly that will have reverberations in terms of the expenditures that are necessary for the application of this risk management technique and those additional costs must be passed on to consumers or absorbed by the producer hedger.

There is also cost in terms of liquidity, as Mr. Wilmoth discussed earlier. The additional cost is the possibility of driving business from our markets into foreign markets or driving business from futures markets into unregulated forward markets.

I find it difficult to justify either of these steps in public policy terms.

Finally, Mr. Chairman, in the remaining time that I have available, I would like to make a few overview comments with respect to the CFTC.

Fortunately, this hearing goes beyond the silver situation. We do not trade silver. The Chicago Mercantile Exchange, as you know, we trade gold, so I will not comment further on silver, but I would like to make a couple of comments about the CFTC as a regulatory agency.

There has been a lot of castigation of the CFTC in recent weeks. It is easy to be a critic and often easy for a fellow regulatory agent to become critical of a sister agency, particularly if vested interests are involved, or particularly if the potential to regulate additional turf is involved.

One must be cautious in appraising critical comments, and though I would by no means be one of the first to praise the CFTC for its performance in recent years, one must keep regulatory activities in perspective; and without any question, the CFTC has done a basically sound job and without any question regulation of this industry ought to continue to be concentrated in just one agency.

We cannot afford to have a proliferation or regulatory activity in the Federal sector which would cause difficulties to all of us.

Finally, it is very easy to, in the aftermath of an emotional situation, such as silver, to castigate the markets and some of the participants in those markets. Again, it is necessary to keep all of this in perspective and recognize that there are sometimes reasons for that criticism surfacing, and those reasons are not always rational.

There is a very great tendency to overreach when a situation like the one in silver comes along every decade or so.

My counsel, with all due respect to this committee and to the Congress as a whole, my counsel where the regulatory agencies are involved, we should all avoid a tendency to overreact. It is easy to spot alleged problems. The real question is whether they are actual problems, and if they be actual problems, whether a Federal solution is appropriate and whether that Federal solution ought to be one demanding more regulation.

In my judgment, there is no need for any additional Federal authority in this area. If there be shortcomings in what has transpired in silver or in any other regulatory arena applicable to futures trading over the last several months, those shortcomings have really been errors of execution rather than of authority.

Thank you, Mr. Chairman.

Mr. GLICKMAN. Thank you for your testimony and your entire statement will appear in the record.

[The prepared statement of Mr. Yeutter may be found on p. 330]

Mr. GLICKMAN. Our next witness is Mr. Walter Vernon, who is the vice president of the Kansas City Board of Trade. He is accompanied by Mr. John Schmid, who is the chairman.

I have met John before, and I have spent many times talking to you, so I will turn the chair back to Mr. Jones.

STATEMENT OF H. R. SCHMID, PRESIDENT, AND WALTER VERNON, EXECUTIVE VICE PRESIDENT, KANSAS CITY BOARD OF TRADE

Mr. SCHMID. Mr. Chairman, we have a full statement which we should thank you to enter into the record.

Here I am going to touch on the high points of it.

Mr. JONES of Tennessee. Without objection, the entire statement will be placed in the record.

[The prepared statement of Mr. Schmid may be found on p. 341]

Mr. SCHMID. The Board of Trade of Kansas City, Mo., with a history of 125 years and more than 100 years of grain futures trading, is clearly one of the old line grain exchanges.

The KCBOT includes among its members millers, processors, exporters, elevator operators, country, subterminal and terminal, cash and futures brokers, grain merchandisers, wire houses, FCM's, a large wholesale baker, and others.

The size of firms ranges from sole proprietorships to some of the largest enterprises in the United States, including several very large marketing cooperatives owned by local elevators, and therefore indirectly by producers.

As a representative of the vast, productive Midwest grain growing and merchandising area and firms, we strongly support continuation of the well-functioning present status of regulation of so-called commodity margins, namely, solely by the exchanges themselves or the CFTC only in an emergency.

Likewise, while we do not understand that the issue of CFTC exclusive regulatory jurisdiction over all commodity futures contracts is before the Congress at this time; however, we do speak up in strong support of CFTC exclusive jurisdiction over all commodity

futures contracts, including our pending stock index futures contract.

The only needed legislative change we see is to provide for some judicial review of CFTC emergency order.

A so-called commodity margin is a mislabeled financial device. In fact, the so-called commodity futures contract margin is no more than an earnest money deposit to guarantee performance, much as the deposit homebuyers put up.

A commodity margin is not a loan to finance the purchase of a commodity, as is the case of regulated security margins by the Federal Reserve Board. No credit is involved. There is no actual commodity being purchased, as with securities, where evidence of title is held as security for repayment by a lender.

Moreover, commodity margin funds are very secure, under longstanding CFTC segregation requirements. Customer funds deposited with FCM's and subsequently paid over to commodity exchange clearing organizations are: (1) Held in segregated bank accounts, where the bank has agreed to hold the funds separate and apart from the funds of the firm, for the account of the customer; (2) Invested only in certain high quality, liquid U.S. securities.

Segregation protection, plus exchange and CFTC financial audits of FCM's, the CFTC's reporting and financial requirements for FCM's now enforced also by exchanges, the fact that positions are brought to market daily or closed out, and the fact the FCM's are responsible to clearinghouses instantly for margin funds in the first instance, combined, make for a safe, smooth functioning system.

Historically, there have been no major scandals or disasters due to improper margins; thus there is no demonstrated need for more governmental regulation. In fact, it can be persuasively argued that commodity margins are safer than security margins for the market participant.

This may be somewhat redundant, but I am going to read it anyway.

In general it may be said that the purpose of commodity margins, other than to guarantee performance, is to protect the financial solvency of FCM's and the clearinghouses, that is, to protect the financial integrity of the total market.

Their purpose is not to regulate prices, nor to regulate speculative activity per se. Generally commodity margins are raised in response to higher variability of commodity futures prices, sometimes called wild gyrations in the press, in order to maintain solvency of all in the markets. When a market settles back down, the margin levels are reduced. While extremely high margins will impact on the volume of futures trade, that is a side effect.

In most situations requiring regulatory market control, there are many other tools available which are better than extremely high margins, such as position limits.

There is a view that commodity speculation fuels inflation. We believe the converse is true; inflation compels drastic action to protect the real value of assets and personal holdings.

In times of currency erosion and times of high price volatility, hedgers need the futures markets even more, which in turn means

there is an increased need for speculators as persons scramble to maintain the total economic value of their estate.

Margins which are unnecessarily high sterilize capital and discourage hedging, both due to the cost and due to a reduction in speculative trades.

Active liquid futures markets tend to be less volatile, over time, than thin markets, where the impact of a single large trade is much greater.

On the expansive CFTC role, we do not believe the proponents of the bill fully appreciate the problems exchanges are now having with the CFTC. Not only does it often take several years to get rules approved, often rules the CFTC required, but a recent policy position has been adopted that the CFTC will take an expansive view of rule approval authority, and more stringent new contract standards are likely.

Thus we fear the bill will encourage inexperienced CFTC staffers to use this authority to regulate prices, since their current thinking is to broaden, not narrow, their regulatory horizons.

We believe on a day-to-day basis, commodity exchange boards elected by their peers, committees, and staffs provide a pool of experienced experts in the respective commodities.

By way of illustration, refer back to our introduction to see the wide range of economic interests represented at the KCBOT, as in all other boards of trade. Aside from the fact that they are all competitors, buyer versus seller, exporter versus importer, et cetera, they are both buyer and seller or seller and buyer for any one commodity.

The CFTC is overly cautious in delivery months. By cautious we mean they are very fearful of any sign of a corner, squeeze, or manipulation, and thus see any slight variation from norm in any of the factors A through D, listed in the bill as the signal of impending market disruption.

Since the press and some in Congress appear more willing, even eager, to criticize lack of action, silver, than taking action—CBOT March 1979 wheat—this puts a premium on doing something, even if it's wrong. To say this another way, we believe the CFTC is already too afraid of markets, is too quick to see problems when often none exist, and does not need any further encouragement to respond to market situations by ordering higher margins only on the basis of one of the factors listed.

For example, as a commercial market we often have heavy deliveries, say 6 million bushels of wheat, between commercial firms with hardly a ripple in the market. Such positions may comprise 50 to 90 percent of the open interest just before delivery. Yet there is no corner, squeeze or manipulation.

Our staff, committees, officers of the Board are well familiar with local market characteristics, yet they could well trouble experts with only a textbook mentality and trigger some margin policy response, which would not only be unnecessary but which could be harmful to the marketing system.

Another example, prices quickly established are no sign in the abstract of a market problem, markets exist to find values; and this role is most vital in unusual situations.

Also there is no pressure on any governmental agency to reduce margins after the situation that caused them to be raised has abated. By contrast, traders representing firms who use the markets want to lower them just as soon as it is safe to do so.

We often note with pride that the grain marketing system, including hedging with futures, permits the grain firms, who together handle massive volumes of grain, feeding the hungry here and abroad, to operate on a small profit margin per unit handled. This permits them to pay more to producers and charge less to consumers.

The cost of hedging is on balance nominal. But if the Government were to unnecessarily raise margins, the result would be a need for more capital on deposit by grain firms. This would increase the cost of marketing, and ultimately be passed on by a charge to the consumer and a reduction in price paid to producers. In a word, it would have both inflationary and income distribution effects.

In 1966 Dr. Roger W. Gray testified before a House subcommittee, at the request of several major banks who were actively engaged in financing hedgers purchases of grain. Much of his paper was directed to general comments in support of hedging, and to specific provisions of the bill then under discussion, H.R. 11788. Most of his remarks are still true today.

The points he made included:

One, low margins encourage easy market entry, providing competitive, active, liquid markets, providing insurance against monopoly power.

Two, raising margins in the face of a manipulation would eliminate the one thing a manipulator does not want, ready traders to take his position.

Three, margin control by government would bring a danger of disruption of well-functioning markets by persons not attuned to the system.

Four, danger of margins so high that use of futures could become prohibitive. A merchant invests capital in a commodity, and will hedge at a low cost, say 5 percent. But at 25 or 50 percent of value, his capital needs have increased to the point where the cost exceeds the protection and, though risky, it becomes more economic not to hedge.

Five, high margins deter speculation, which is needed to make the markets efficient.

Six, higher margins would force smaller traders out of the market, increasing concentration.

Seven, high margins in some commodities would send traders abroad.

In conclusion, while it may be true that Franklin D. Roosevelt and Harry S. Truman urged commodity margin control, of much greater significance is the fact that Congress, wisely in our judgment, has refused on repeated occasions over 40 or 50 years to give any Government agency authority over commodity margins.

We have attached a list of prior published presentations opposing commodity margin regulatory authority in the Federal Government, and some textbook discussions of margins, if a more theoretic-

cal analysis would be helpful, which we would call to your attention.

We wish to conclude by quoting from part of the paper prepared by Dr. Roger W. Gray of Stanford, and presented to a similar hearing in 1966, as already mentioned:

Considered against the background of even this minimal understanding of the system, the provisions of H.R. 11788 pertaining to margins must be unalterably opposed as reflecting lack of understanding, as ascribing to margin requirements a novel and alien purpose which they were never intended to serve; and as posing the threat of raising marketing costs and disrupting the marketing system, without offering any real prospect of accomplishing the purposes there ascribed to them.

Mr. JONES of Tennessee. I am going to have to ask you to wind it up, because you have taken a lot more time than is allotted. It will appear in the record. We will have a right to read it anyway.

Mr. SCHMID. I would like to ask, Mr. Chairman, whether we could send a letter and answer several of the questions that have been before this committee in which we did not think were answered very well, if we may be able to send this to the committee.

Mr. JONES of Tennessee. We will be submitting some questions. Each committee member will have a right to do that at the end of the session.

Thank you, Mr. Schmid and Mr. Vernon.

[The prepared statement of Mr. Schmid may be found on p. 341.]

Mr. JONES of Tennessee. The next witness is Mr. Lee H. Berendt, president, Commodity Exchange, Inc.

Welcome, we will be glad to hear you at this time.

STATEMENT OF LEE H. BERENDT, PRESIDENT, COMMODITY EXCHANGE, INC.

Mr. BERENDT. Mr. Chairman and members of the committee, my name is Lee H. Berendt and I am president of Commodity Exchange, Inc., better known to you as Comex.

Initially, let me express my appreciation to this subcommittee for its invitation to testify today. Since our appearance before this committee in connection with the CFTC reauthorization hearings in 1978, a number of issues have arisen that are presently subjects of concern to you.

First—events in the silver market culminating in the price declines during the week ended March 28, 1980. Second—margin on futures contracts and whether exchanges or some other entity should establish the same. Third—the issue of jurisdiction over futures contracts including the two subissues of which Federal agency should retain or obtain such jurisdiction and which congressional committees should maintain or obtain oversight responsibilities.

We have furnished to this committee two documents which address those issues in detail. Those documents are entitled: One "Statement of Commodity Exchange, Inc."; and Two "Chronology of Activities Relating to the Silver Market from September 1979 through March 1980."

I respectfully request that both of those documents be included in the record of these hearings.

Mr. JONES of Tennessee. Without objection, they will be made a part of the record.

[The prepared statement of Mr. Berendt may be found on p. 365. The chronology of activities is held in the subcommittee file.]

Mr. BERENDT. I will touch on the points which I think are of interest to this committee.

The statement of Commodity Exchange, Inc. includes as attachments extensive memoranda on the legislative history of and policy issues surrounding the margin and jurisdiction questions.

We believe that they clearly demonstrate that the continuing responsibility and authority for establishment of levels of original margin should remain with the futures exchanges, and that the exclusive jurisdiction of the CFTC and the concomitant oversight responsibilities of the House and Senate Agriculture Committees are both necessary and desirable.

As shown in our submission for the record, the idea of Government authority over futures margins is anything but new. In fact, the Congress has considered and rejected this concept on at least 10 occasions since 1948. The process structured by this committee and its Senate counterpart in 1974, and then reaffirmed in 1978, for permitting exchanges to establish margin levels has worked effectively. It has enabled the body with the most expertise and up to the minute market information to determine how best to protect the marketplace and its participants against price volatility, thereby assuring its continuing financial integrity. In the nearly 50 years of Comex's existence, no member firm has ever failed as a result of any business done on any futures exchange and caused the loss of any customer funds. One of the principal reasons for this unblemished record of financial stability has been the effective establishment of original margin requirements.

Exchanges must carefully balance two interests. First, the level must be kept high enough to insure financial responsibility.

Second, the level must be low enough to insure continuing market liquidity enabling market participants to enter and exit the market in a prompt and orderly manner. It must be remembered that liquidity is as vital a factor in insuring financial stability as are high original margin levels.

If a market participant with a deteriorating position is unable to close out that position for 3 or 4 days because of an insufficient number of buyers or sellers, financial risk may be greater than if levels of margin had been set at unnecessarily low levels.

We at Comex believe that we have developed a most effective system to establish original margin levels. First, the use of a threshold formula devised by our margin committee enables us to develop parameters, highs and lows, for margin levels within which margins would satisfactorily secure customers positions.

Then the margin committee, through its constant monitoring and thorough understanding of our markets, is able to fine-tune those limits to a level, within the permissible parameters, that is designed to insure continuing liquidity in our markets. Because of the foregoing, we believe that Comex and the other contract markets are best able to determine appropriate levels of original margin.

We share Congressman's Glickman's concern that in emergency circumstances the CFTC should have the authority to establish original margin levels. However, we note that in 1974 Congress

added section 8a(9) to the Commodity Exchange Act. That section gives the Commission emergency authority to direct contract markets to take such actions as the Commission determines to be necessary in emergency situations. We believe the section 8a(9) emergency authority clearly extends to establishment of emergency margin levels. The CFTC has taken this position since its inception in 1975 and, in fact, used its emergency power in 1976 to establish 100 percent margins in the potato futures market.

Furthermore, the recent appellate court decision in the Chicago Board of Trade *wheat* case, which the Supreme Court refused to review, holds that the CFTC's use of its emergency powers is not judicially reviewable. Therefore, we believe H.R. 7183, which was introduced almost simultaneously with the Supreme Court decision, is now unnecessary.

Furthermore, although Congressman Glickman stated that: "The bill includes safeguards to insure that margins to protect the market could only be set under very unusual or emergency circumstances," the language of H.R. 7183 appears to go beyond emergency powers and give the CFTC authority to establish margin in virtually any situation.

With respect to the issue of exclusive jurisdiction, we believe that the multiplicity of hearings held and still being held before various Senate and House Committees is sufficient demonstration of the absolute necessity for exclusive jurisdiction over the futures markets in the CFTC and exclusive oversight responsibility in the House and Senate Agriculture Committees. Two facts have become apparent during these hearings.

First, the Senate and House Agricultural Committees, with collective experience in futures legislation going back 58 years to the Grain Futures Act of 1922, and 6 years of oversight responsibility for the CFTC, have the sophistication and expertise to deal with the complex field of futures trading.

Second, the duplication of testimony, and of time spent in preparation for that testimony, on identical issues before different committees has already constituted a significant drain on the resources of all Federal agencies involved, not only the CFTC, but also the Securities and Exchange Commission, the Federal Reserve Board and the Department of the Treasury. This current drain forebodes a much greater burden which these agencies, and ultimately the taxpaying public, will experience if proposals to split jurisdiction are enacted. Also, such an approach could well cause market disruptions based on disparate regulatory, rather than market factors. Thus, any jurisdictional split can only result in duplication of regulation and oversight without any discernible benefit.

Accordingly, we strenuously urge this committee to reaffirm the wisdom of its 1974 and 1978 decisions and take all steps within its power to see that jurisdiction over futures contracts remains within the exclusive domain of the CFTC.

By this time, this committee has heard extensive testimony relating to the silver market and our written materials deal with those matters in detail. Rather than belabor these general issues, we will attempt to focus our comments on certain unique questions relating to Comex which have received substantial attention in the media.

Questions have been raised with respect to the board of governors of Comex and the propriety of its actions, first in progressively increasing margin requirements on silver futures contracts during 1979 and, second, in establishing position limits in the silver market and limiting trading to liquidation only in early 1980.

An understanding of the composition and structure of the Comex board is necessary in order to evaluate its actions.

We at Comex are proud of the fact that our board of governors is the most balanced and diversified of all futures exchange boards. Our board consists of 25 governors, 7 representatives of commission houses, 7 representatives of metal trade houses, 7 representatives of the floor brokerage community, two members of the Exchange that do not fall within any of those three categories, and two public governors.

We have recently amended our by-laws to allow four members of the board to be public governors.

During the period in question, the two public governors of Comex were Dr. Andrew F. Brimmer, a former Governor of the Federal Reserve System, and William E. Simon, a former Secretary of the Treasury. A list of all other members of the Comex board is contained in the chronology previously submitted to you.

Suggestions have been made that the margin increases that were regularly effected at Comex during the last 4 months of 1979 were unnecessary. However, those who would make that suggestion fail to understand the meaning and impacts of futures margin requirements.

Since margin on futures contracts should be directly proportional to the volatility of the futures contract, it should be apparent that any time contract prices are fluctuating dramatically, irrespective of whether those fluctuations are up or down, larger margin requirements are necessary to protect the marketplace.

During the 4-month period from September through December 1979, silver prices frequently varied from 1 day to the next by well in excess of \$1 per ounce and on some days by as much as \$5 per ounce.

Such volatility was never before experienced in Comex's silver market, and as a result dramatically increased margin requirements were necessary.

A \$5 price move in 1 day represents a \$25,000 loss per contract for a market participant if the price moves against him. In times of that sort of volatility, an original margin requirement of \$50,000 to \$75,000, or 2 to 3 days of dramatic price swings, is far from unusual. Indeed, it is essential.

In light of such volatility and of the dramatic world events which were causing significant uncertainty in the futures markets, very high margin requirements became a necessity to insure that market participants would be able to meet several days of large variation margin calls.

Two significant decisions were made by the Comex board on January 7 and January 21, 1980. Those were, respectively, the imposition of position limits and the limitation of trading in silver futures contracts to liquidation only.

The first of those steps was accomplished at a time when large deliveries of silver had been taken in London and on Comex, and

when the large positions in the Comex silver market of both the Hunt family and a group of foreign investors created a significant potential for congestion in the marketplace, with the possibility that March 1980 futures contracts and other subsequent maturities might not liquidate in an orderly fashion.

The second step, liquidation only trading, was also taken at a time when the position limit rule, imposed 2 weeks earlier, did not seem to be resolving those problems and when small accounts were being opened apparently by persons with previous positions in the silver market, as a method of circumventing the position limit rule.

Thus it became necessary: One, to attempt to bring about a reduction in large positions; two, to generally reduce the open interest on Comex to insure orderly liquidation of maturing silver futures contracts; and three to prevent any new positions being taken in the market in contravention of the position limit rule.

At the meeting of the Comex board on January 7 when the silver position limit rule was adopted, 20 members of the board were present. Of those persons, 18 voted in favor of the position limit rule and two persons abstained. The 18 affirmative votes included the votes of the public governors as well as a broad distribution of votes from the three groups principally represented on the Comex board.

Of those 18, only 4 had short positions. Those four were members of the trade group. However, most significantly, those 4 trade members did not stand to gain or lose from board actions since they were fully hedged. In other words, as their futures position went down, their physical position went up.

Similarly, on January 21, 1980, when the Comex board imposed a liquidation only trading order in the silver futures market, 15 members of the board were present:

Ten voted in favor of the order and 5 abstained. The 10 voting in favor included one public governor, the other public governor was not present at the meeting, and a broad distribution of the three groups comprising the Comex board.

Having witnessed those board meetings and having been privy to the extensive and difficult discussions relating to those two issues, I can assure this committee that the Comex board acted diligently, responsibly, and in good faith in a manner designed solely for the purpose of equitably discharging its self-regulatory obligations.

Any suggestion that the actions of the Comex board caused the decline in silver prices fails to take into account two extremely important facts. First, during this same period the price of gold was declining dramatically and the similar decline in silver prices may have been reflective of the traditional relationship between gold and silver.

Furthermore, at no time in 1980 has the price of silver futures contracts on Comex deviated materially from the price of silver in other futures markets or from the price of silver in cash markets in London, Zurich and Hong Kong.

Thus, there are perfectly reasonable and logical explanations for silver's decline on Comex and there is absolutely no evidence that the actions of the Comex board had any impact whatsoever on the price of silver or that any Comex Governor intended to benefit, or did benefit, from the actions of the Comex board.

During the week of March 24, 1980, the Comex board was presented with several difficult issues arising principally from the default of the Hunts in meeting margin calls at several major brokerage houses. During that week and the weeks that followed, the audit department of Comex conducted audits of a number of brokerage firms, in three instances on a virtually daily basis.

The principal purpose of those audits was to insure the financial integrity and responsibility of member firms of Comex. At no time during that week did any Comex member firm violate the exchange's minimum financial requirements or otherwise violate any of its capital rules.

Subsequent to that week various Comex investigations have continued. We have requested three of our member firms to furnish us with detailed statements describing their internal procedures relating to margin practices before and after the week of March 24.

We have also continued to prosecute diligently all potential violations of our position limit rule. We are presently conducting approximately 25 investigations of such potential violations.

I firmly believe that, notwithstanding the many difficult moments for Comex from September 1979 through March 1980, the silver market during that period and the Comex actions relating thereto demonstrate that self-regulation can be effective.

The ability of Comex to deal with the difficult problems and ultimately to insure that no customer was victimized, that no brokerage firm collapsed, that the financial viability of the Comex silver futures contract was maintained, and that the silver market survived, demonstrates that point.

The carefully weighed decisions of the Congress in 1974 and 1978 concerning jurisdiction, margin authority, and the respective powers of the CFTC and the exchanges were proven correct during this difficult period.

Both the exchanges and the CFTC had the necessary tools within the existing statutory framework to deal with all the problems that were encountered and the wisdom to use those tools with restraint.

Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Berendt.

We are going to have to recess for 15 minutes in order to go vote on final passage of a bill. We have one more witness.

[Short recess.]

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will resume its sitting. Mr. Bennett Corn, president of the New York Coffee, Sugar and Cocoa Exchange of New York, is our last witness. We welcome you. You may proceed.

**STATEMENT OF BENNETT J. CORN, PRESIDENT, NEW YORK
COFFEE, SUGAR AND COCOA EXCHANGE, NEW YORK, N.Y.**

Mr. CORN. Thank you, Mr. Chairman. I appreciate the opportunity to testify before your committee. In order to comply with your 10-minute rule, Mr. Chairman, I shall submit my written statement for the record and summarize part of it orally. I will also add some observations prompted by yesterday's testimony.

[The prepared statement of Mr. Corn may be found on p. 377.]

Mr. CORN. The Coffee, Sugar and Cocoa Exchange is the only exchange in America that exclusively trades contracts for the

future delivery of commodities that are produced abroad and that are all the subject of active trading in foreign markets. In fact, our market and the foreign markets together really constitute a single world marketplace that has several points of entry, of which New York is only one. Therefore, as we discuss alternatives of regulation, we should keep in mind that any actions that have a restrictive effort on trading activities here will inevitably make other points of entry to the world market more attractive.

The exchange has been in existence since 1882. Until 1975, it successfully regulated its markets for nearly a century without governmental regulations. We have taken our self-regulatory role very seriously, and since 1975 we have committed a great deal of time and resources to meeting the new responsibilities that were placed upon us.

The details of how this has been accomplished are set forth in my written statement. Suffice it to say for now that the size and professionalism of our staff, particularly those involved in market surveillance and rule enforcement, have increased dramatically over the past 5 years.

I believe that the recent events in the silver market prove the responsiveness of our exchange to the need for properly regulating our marketplace. For 4 consecutive days after the first rumors were heard that major problems might be developing in the silver market, the exchange and/or its affiliated clearing associations held board or committee meetings running long hours late into the day.

We knew that a number of our members had large commitments in the silver market as well as in our markets. We were keenly sensitive to the fact that if any of our members ran into financial difficulties in silver, the effects could spill over into our markets. Representatives of the clearing members affected were called in repeatedly, and their financial positions were closely monitored.

Our surveillance staff sent auditors out to member firms, and we sought and obtained a steady flow of information from the CFTC, from other exchanges and from various banks. Finally, as one more safeguard, the exchange's affiliated clearing associations called upon their members to turn over an increased proportion of customer margins held by them. The call was issued Friday afternoon, March 28, and by Monday noon, March 31, over \$60 million additional had been deposited with the clearing associations.

If at any time we believed that any of our members were in trouble, we were fully prepared to take whatever action seemed appropriate to protect the financial integrity of our markets, including the forced liquidation of positions, if necessary.

All our actions in that last week of March were carried out without Government prodding or intervention of any kind. We acted because of our sense of self-regulatory responsibility—responsibility to both the public and, to be perfectly frank, to ourselves. For if the truth be told, the strongest motivating force for strong, effective self-regulation is the enlightened self-interest of our members.

This committee has sought testimony regarding the question of whether the system of self-regulation presents a possible conflict of

interest for industry members who serve on exchange boards and committees.

The exchange is dependent on its members to give it the necessary expertise to carry out its regulatory duties. Frequently, the exchange must make decisions with regard to market conditions: Decisions on the adequacy of deliverable supply, for example, or the potential market impact of certain developments. Such decisions require the exercise of informed judgment. No one in Government—and for that matter, few members of the exchange staff—has the knowledge and the experienced feel for the markets that is necessary.

Of course, the fact that board members may have an interest in particular market situations does raise the potential for conflicts of interest. However, we have a number of safeguards to prevent these potential conflicts from affecting the decisionmaking powers in ways that are adverse to the marketplace. For example, when emergency market conditions are discussed, board members of our exchange are required to disclose whether they hold positions and, if so, on which side of the market. Almost invariably there will be persons present holding positions on opposite sides.

When sensitive votes have been taken, interested parties have excused themselves from voting. In addition, the exchange board of managers has a public member who is a distinguished figure in the academic community, and who is neither a member of the exchange nor involved in any of the trades the exchange services.

They further say that our board is made up of representatives of the sugar, coffee and cocoa trades, the FCM community, the floor community, and we have a public member and we could have as many as three public members in accordance with our rules.

Several proposals now before this committee and other committees of Congress would place standby authority over commodity margins with an agency or department of the Federal Government. These proposals misconceive the proper functions of margins in the commodities industry and would result in serious adverse consequences, particularly in the case of commodities such as ours that are traded in the world marketplace.

Much has been said recently on the question of whether excessive credit helped to inflate the speculative bubble in silver. But exchange margins do not represent extensions of credit; they are merely security deposits. Even if exchanges were to require 100 percent margin, exchange margin levels would have little effect on overall market prices of commodities, so long as large traders are free to finance inventories, to engage in margin-free forward transactions and to borrow monies to meet futures margins from bankers or brokers or elsewhere.

In other words, if the problem is perceived to be excessive credit, exchange margin levels are not the way to address that problem.

This point takes on even more meaning in light of the testimony you heard yesterday in which Commissioner Dunn observed that at the peak of the silver bubble the majority of the Hunt positions was in physical silver, not futures, and as Chairman Volcker and others observed, physicals in futures are really just one market, with futures prices only reflecting conditions in the cash market.

So far no one has demonstrated why governmental control over margins would be any superior to exchange control how the silver incidents would have been handled any better. To the contrary, I see a number of serious problems that could result from now giving margin authority to the governmental agency.

First and perhaps most important from the standpoint of an international exchange such as ours, burdensome margin regulation will inevitably result in driving trading abroad. A person buying coffee, sugar or cocoa on the world market—whether he is located here or abroad—has ready access to the foreign exchanges as well as our exchange to hedge his purchases. There are no governmentally imposed margins—indeed, very little governmental regulation of any kind—on the foreign exchanges. If we make American exchanges less attractive, it follows that the foreign exchanges—which, as I said before, are really part of one global market—will appear more attractive.

Not only will we see an exodus of capital to these foreign markets; at the same time, we will lose regulatory control over the trading that moves outside of our borders, even though that trading will directly influence market conditions within the United States.

Two other problems which are discussed at more length in my written statement are, first, the concern that governmentally-set margins would be too high, thus increasing costs of production and inflationary pressures; and second, the Government would not be able to respond quickly to changing margin circumstances in order to keep margins at proper levels.

My last point deals with the adequacy of CFTC regulatory powers. The CFTC has pervasive regulatory powers over all the commodity exchanges in the United States. These include extraordinary powers to order exchanges to take whatever actions the Commission deems appropriate to deal with market emergencies. The CFTC asserts those emergency powers even over margins. Taken together, the powers are sufficient and no more are needed.

However, while we are on this subject, let me mention a collateral point. Recently the Court of Appeals for the Seventh Circuit ruled that Congress intended the exercise of CFTC emergency powers to be immune from judicial review. The Supreme Court denied certiorari. With all due respect, we cannot believe that Congress really intended to give such massive powers to a governmental agency such as the CFTC absolutely free of any judicial review whatsoever. In considering any legislation in this area, we urge the committee to consider this issue and to restore the fundamental right to obtain judicial review of CFTC emergency decisions.

Aside from that, Mr. Chairman, the present regulatory framework works. There is no reason to change it.

I thank you very much.

Mr. JONES of Tennessee. Thank you very much, Mr. Corn.

That completes the roster of witnesses for the afternoon, and under the rules of the subcommittee, there will be 5 minutes allotted to each member of the subcommittee for the first round of questions. If there are more, we will be given a second round.

Mr. Berendt and Mr. Wilmouth, I have a question that I would like to direct to you, and I suspect that it will consume my 5 minutes, so I will just get to the point as quickly as possible, and let one of you at a time answer.

This morning we had a couple of witnesses who seemed to be making serious charges against your exchanges. Are you familiar with what was said here this morning by Mr. Sibbet and Mr. Walsh?

Mr. WILMOUTH. I think in general we are.

Mr. JONES of Tennessee. Mr. Wilmouth, would you start off by taking a few minutes of my 5 minutes, whatever you need, and if Mr. Berendt can't get to it, why, we will probably have a second round anyway, and respond to these charges. I think it is something that is quite important to this subcommittee.

Mr. WILMOUTH. Let me make a general statement, if I may. First, Mr. Chairman, again, I was not present this morning but my associates told me of the discussions. If I understood correctly, there was some type of a vague conspiracy charge which would have included, if I understand the remarks correctly, a former attorney general of the United States, a former Secretary of the Treasury of the United States, two former Governors of the Federal Reserve Board, and others, for example. I think that what the gentleman was probably talking about was possible conflicts of interest internally within the board as amongst the various exchanges and the Government.

I can just say categorically that there were no conspiracies whatsoever, so far as the board of trade is concerned, with any other party whatsoever. We had no direct contact with the Fed or anyone else with respect to what went on in silver in terms of the Government except the CFTC.

We have very strong internal conflict of interest guidelines for our people. Put very simply and basically, our directors don't act contrary to our rules, and our directors don't act in bad faith, because the consequences are very serious.

More simply put, I think in everyday parlance, we kind of pay attention to our gut, and if a member has a substantial position in a contract under discussion, he gets out of it, or he abstains from debate and voting on the matter. To avoid even the appearance of a conflict of interest we use an abundance of caution, and let me cite as evidence of that what happened in the recent silver discussion.

Last October, on October 25 to be specific, when we took very decisive action to limit positions in the silver market, our chairman, who did have substantial holdings in the silver market, excused himself from the meeting, was not even present at any of the meeting whatsoever. All of the other directors of the Chicago Board of Trade were polled for the record on their holdings, to assure ourselves that no conflict of interests were involved, and I can assure you that there were none. Mr. Berendt may want to make some additional comments on that.

Mr. BERENDT. Mr. Chairman, in response to your question, about the allegations this morning of James Sibbet, we don't believe most of what Mr. Sibbet said is accurate or valid. There were several points that he raised, one of which, you will recall, was the ex-

change should have taken action when the price of silver was \$18, and if we had done so, the problem that existed in the silver market wouldn't have occurred.

I think it is important that this committee and everyone else understand that exchanges do not take action based on price. We are a marketplace, and a marketplace only. We don't act because the price of the commodities we trade is going too high or going too low, or because a member of the exchange or a member of the board is not happy with a price level. That is not what motivates an exchange to act. Therefore, Mr. Sibbet's view that if we had taken the steps we took at \$18, rather than at the level that the action was taken, there wouldn't be a problem, is irrelevant. We do not know if the series of events would have changed had we acted when Mr. Sibbet suggested. But we can tell you that price does not affect the judgment of an exchange or a marketplace.

In addition, Mr. Sibbet said the market had reached the point where the Arabs and the Hunts were on one side and that the members of the exchange were on the other, and the actions of the Comex board were taken to help the members of the exchange who were having difficulty.

That is not the case and was not the case. The fact is that there was a reduction in the liquidity of the marketplace. The marketplace was in need of self-regulatory action. The board of Comex was working with this problem from September through March. You will recall, if you have seen our chronology, that the board dealt with this problem on some 34 separate occasions in a period of 6 months, when normally the board would have met 6 times. The board of the exchange has only a certain number of self-regulatory tools at its disposal, as does any organization, whether it be a Federal agency or an exchange. We could raise margins, impose position limits, limit trading to liquidation, take selective action against holders of contracts in the market, or close the market and settle the contracts. What the board of Comex did from September on was to consider in a methodical and thoughtful way, the various actions that were available to them, and took that action that they felt was necessary and appropriate at the time. Basically, we believe that the things that Mr. Sibbet said are not accurate, and they do not reflect the correct set of circumstances that were in existence throughout the period in question.

Mr. JONES of Tennessee. Thank you, Mr. Berendt. I would like to pursue that a little further, but I am going to yield to Mr. Madigan now, who must leave the hearing for the time being. Mr. Madigan.

Mr. MADIGAN. Thank you, Mr. Chairman.

Mr. Rose, a member of our committee who is chairing another committee this afternoon, has asked that a question be asked of you, Mr. Berendt, and I will read his question. Actually, he has three, but I believe that your statement already responds to two of the questions. The unanswered question is: Did the Comex have a special committee called the silver committee? If so, would you describe its function, and if it did exist, was it disbanded before January 20?

Mr. BERENDT. The answer to the question, Congressman, is yes, we did have a special silver committee. The committee was appointed in the early part of October. It was appointed with the

express directive of the Board of Governors of the exchange to deal with the December silver situation. It was then extended into January. The original concept was that the special silver committee would act as a disinterested party, would consider the situation that was developing in the December silver contract, would meet with members of the exchange holding positions, as well as people that were not members of the exchange, in order to determine what action, if any, should be taken to make sure that there would be an orderly liquidation of the December futures contract.

Mr. MADIGAN. You expressed a concern about the volatility in up-and-down pricing swings, and initially I thought your statement justified the actions that your board was taking because of those up-and-down price swings.

I wonder if a limit on up-and-down movements like exist on the board of trade for grain commodities would not do the same thing?

Mr. BERENDT. If you are referring to a daily price limit, we have daily price limits on the existing commodities traded on Comex. All contracts are subject to those limits, with the exception of the spot or current month. There is always one month which is trading without a limit, but we do have a daily price limit in effect.

Mr. MADIGAN. So how is it that you have the volatility that you referred to in up-and-down price movements in silver, and at the same time you have daily limits?

Mr. BERENDT. What happens, and what we saw happen several times during the past period under discussion, is that the cash market or the spot price would move in an amount greater than the daily permissible price limit of the months on which the limits apply, which then meant that you have a period of time—several days of trading—where the other months, the months that were subject to limits, have to catch up with the spot or other months trading without a limit. Therefore, in effect, even though most contracts are subject to daily price limits, all of the months are subject to the same volatility and the same problems to which the spot month, or the month that reflects volatility every day, is subject.

Mr. MADIGAN. Both you and Mr. Wilmouth have referred to the relationship between gold and silver. Mr. Wilmouth said that gold and silver—I think I quote him correctly—move in tandem. You referred to the traditional relationship between gold and silver.

We have tried to make a chart tracking the movement of gold and silver, and find according to this chart that there is a traditional relationship, and that silver had a high of \$50 when gold had a high of \$850. The two went up in tandem. The two came down in tandem, but then of course there is a point in silver where silver drops much more than gold. The gold leveled out. The silver went all the way down to I believe \$11.34. It seems that when they left their tandem connection, that that coincides with the Chicago Board of Trade and Comex beginning to impose these new regulations. That leads one to the conclusion that the new regulations were responsible for the breaking of that traditional relationship, and the sinking of the silver price.

Would you agree with that, Mr. Wilmouth?

Mr. WILMOUTH. No, sir, not necessarily.

I don't think there is any doubt but that some of the action that was taken over a period of time did cause a bit of that, but I think I would more importantly point out that probably several other factors came into being. One of the most important ones being the fact that I think general fears that had forced people into gold and silver began to subside. We have a chart in our presentation which indicates very clearly, and I think precisely, that when the Iranian crisis occurs, the Russian invasion of Afghanistan occurred, going back to the ownership of gold, the Arab-Israeli war, things of that nature, that it always goes up.

Back in January there was some feeling that maybe we didn't have to stay with gold and silver, but could get back into paper, and even more importantly than that—which helped to cause part of the downfall—was the fact that a lot of silver began to appear. One of our concerns in the early months and later months of 1979 was the fact there was not enough deliverable supply of silver to meet the contracts had everyone decided to take delivery on the contracts.

As that fact became known, more silver came out of the woodwork. Aunt Minnie from Dubuque, Iowa, would take the silver out of the buffet or take the coins and melt those down, which added silver to the market, and that helped also to cause some of the price decline.

Other people might very well have been taking profits, but I think those factors are more important than the ones of the specific actions that we took.

Mr. MADIGAN. My time has expired, Mr. Chairman. I appreciate your allowing me to go out of turn. I have to go to the floor of the House and I hope that you will excuse me.

Mr. JONES of Tennessee. Thank you, Mr. Madigan.

The subcommittee stands in recess for 15 minutes to vote.

[Short recess.]

Mr. GLICKMAN. Why don't we get started. We have a few members to ask questions, and there will be no votes, to the best of our knowledge, so we will go through once and probably go through twice, so that each member will have more than enough time to ask questions.

Is Dr. Yeutter here?

Just for curiosity, it strikes me a little bit amusing how you all are so happy with the CFTC. What if you had three Jim Stones as Commissioners; how would you feel then?

Mr. WILMOUTH. I think our happiness with the CFTC would revolve more around the fact we have Commissioner Dunn, Commissioner Gartner, and Bob Martin, who have an understanding of the role that commodities play in the role of the futures industry. If you go back, you will find the former Commissioner of the CFTC Garry Severs shares that same view, and the former CFTC chief economist, Mark Powers of McKinnon, shares that.

Mr. GLICKMAN. My only point to you is if you live by the sword you die by the sword, and that if the Commission begins to assert a different position, I am just going to generally remind you that you have taken a pretty favorable position towards the CFTC today, and that is part of our process, is to make the laws so that they work no matter really who the administrators of the agency are.

Mr. WILMOUTH. Yes. Mr. Glickman, if I may, I think specifically my comments were directed to the fact that I thought in the silver episode that the CFTC performed its function as it should. I think I also made a point that I think the CFTC overstepped its boundaries with respect to the March 1979 wheat situation.

Mr. GLICKMAN. Mr. Berendt provided this committee, I don't know how comprehensive it is but at least a statement of actions taken by the board of directors, taken at the time their actions were taken, together with some description as to whether those members of the board held short positions or not, what kind of position they were in at the time.

You talked about the abstentions. I assume abstentions were people who had some interest in the matter or else they abstained because they didn't know anything about it. I am wondering whether the other exchanges—and I guess it was primarily yours, Mr. Wilmouth—would provide this committee with a description of the holdings, silver holdings by members of the board of directors at the time relevant actions were taken by the Board of Trade.

Mr. WILMOUTH. Are you talking about specific positions that they held, Mr. Glickman?

Mr. GLICKMAN. Well, I would be talking about perhaps specific positions, but all relevant financial interests in silver which would have, to a reasonable person, a bearing on their decisions regarding liquidation and other actions that were taken.

Mr. WILMOUTH. Let me tell you in the detailed presentations that we have put forward, for example, we have given that information in relevant cases. I think on October 25 that when we took the actions to limit positions we polled our directors. Several had positions, but they were spread positions. They were short five contracts in December and long five contracts in February. We did not consider that to be a conflict of interest.

Mr. GLICKMAN. But you did say your chairman held a significant position?

Mr. WILMOUTH. He did, sir, and he was not a party to the meetings whatsoever. He absented himself from the meetings that revolved around silver discussions.

Mr. GLICKMAN. For the record, who is your chairman?

Mr. WILMOUTH. It is Mr. Gruetzmacher with me today. At that time our chairman was Ralph Peters.

Mr. GLICKMAN. His firm is what?

Mr. WILMOUTH. Peters and Co., an independent brokerage house and FCM.

Mr. GLICKMAN. Speaking for myself, I am going to review that record, and if I have additional questions, I might not have the right questions to ask you today, so I am not going to do it until I know what the specifics are. Some of them may be in the questions raised this morning in the testimony of the gentleman from Massachusetts, but this committee—I will have to talk to the chairman of the committee—may have additional questions that they will want to ask you relating to the conflict-of-interest questions, and I assume that relevant boards or exchanges will be free to answer those questions. Is that correct?

Mr. WILMOUTH. Yes, sir.

Mr. GLICKMAN. I would like to talk a bit of philosophy for a moment. If the Hunts had not been in the market, would silver have gone up like it did?

Mr. WILMOUTH. That is a rather difficult question to answer. My belief is that silver was an undervalued commodity and, yes, it would have gone up.

Mr. GLICKMAN. To the same levels?

Mr. WILMOUTH. I think it is entirely possible that silver would have gone up to the same levels.

Mr. GLICKMAN. Possible. Does anybody else have any comments on that question?

I guess you don't. Let me ask you another philosophy question. Mr. Vernon talked about a Dr. Gray who testified in 1966 about the factor, maybe it was Mr. Schmidt, about low margins encourage market entry and can lead to a competitive, active, liquid market, but you all would have to agree that the futures market has changed dramatically in the last 10 years in terms of volumes, in terms of numbers of individuals who are now participants, in terms of the substantial additional public customers involved in the futures markets.

If you do agree with that statement, and in my judgment the No. 2 premise is the main purpose of the futures markets is to provide some sort of hedging and liquidity foundation for people who otherwise hold solid positions in either grains or metals, and they are doing it as a hedging transaction. What I am asking you is, do we have a different ballgame today than we did 10 or 15 or 20 years ago, in terms of numbers of additional people who are truly speculating today as opposed to what they were 10 or 15 years ago? And might we want to consider changing the underlying regulatory or legislative authority a bit because of that? Mr. Schmid.

Mr. SCHMID. Mr. Chairman, may I answer this? Yes, I think we do have somewhat of a different ballgame in that respect, that first of all the trade, the cash trade also is considerably larger than 10-15 years ago. In addition, 10 to 15 years ago our currency was quite a stable currency yet, and that has changed considerably. And I think it is on account of the change in the stability of the currency that inflation has come, and speculation has been encouraged.

Chairman Volcker has alluded to that several times in a statement on April 30 that he made.

Mr. GLICKMAN. But Chairman Volcker also alluded yesterday to the statement that because of that we may need to explore the need for perhaps additional margins, but at the same time recognizing that fine balance between overregulation and none at all. My worry is that we have an enormously different financial situation than we had 15 or 20 years ago, and I just want to make sure that our legislative foundation is sufficient.

Dr. Yeutter and then I will finish.

Mr. YEUTTER. I don't agree with Chairman Volcker's comments yesterday on that point, Mr. Chairman. I thought his comments a few days earlier were more meritorious than the ones that he made yesterday, but nevertheless, from conversations that others have had with him in the last couple of days, it is apparent that the chairman is open-minded on this issue, does want to have a very thorough and comprehensive study, and does believe that certainly

nothing precipitous should be done in the way of additional legislation, and that is sound. But to go to your specific, Mr. Glickman, there is no question that it is a completely different ballgame.

The level of economic interest is infinitely greater today than it was 20 years ago or 15 years ago, and will probably be infinitely greater in 1990 than it is today. That being the case, clearly the degree of public interest or the extent of public interest, interest of the public is so much greater than it was 10 or 15 years ago. Therefore, all of us, whether we be in Congress or in the private sector or in a regulatory agency, must have a much greater sense of public responsibility to the management of this industry, and its impact on our economy and on the world economy. We have to be far more sensitive to that impact than we would have had to have been 10 or 20 years ago.

I hope we are doing so. Clearly, that calls for much greater surveillance over the conduct of the market than was required perhaps even 5 or 10 years ago, but in terms of legislative authority, it seems to me that is another question. As I said in my earlier testimony, I find no shortcomings in legislative authority. As you know, I was very much involved in the preparation and submission of the original legislation to establish the CFTC. I am still very comfortable with the basic legislative authority that is there. I don't see any need for any additional legislative authority. I very much disagree with Chairman Stone's comments in this direction, and neither do I see the need for the authority that is incorporated in the legislation that you have introduced.

Mr. GLICKMAN. Thank you, Mr. Richmond.

Mr. RICHMOND. Thank you, Mr. Glickman. I just have one quick question for Mr. Corn.

Can you tell us all why, in your opinion, the price of sugar has doubled in the last 6 months?

Mr. CORN. I think it has to do a lot with the world situation where there are extreme shortages and droughts. There have been some stories about some shortages in Cuba, and there have been some droughts, some political situations around the world in Central America where there has been revolution, which has disrupted the supply of sugar coming into consuming countries; general inflationary factors I think are some of the reasons that have affected the price of sugar in the last year.

Mr. RICHMOND. What about Brazil and the Philippines converting a lot of their sugar to gasoline?

Mr. CORN. Yes, I would think that also. I am not an economist, but these are the types of things that we are hearing about at the exchange.

Mr. RICHMOND. Is the price of sugar around 30 cents now because of a general world shortage of sugar?

Mr. CORN. That, plus general inflationary factors and political conditions in the world today have disrupted some normal supply areas that would normally come into the marketplace.

Mr. RICHMOND. Mr. Berendt, Mr. Wilmouth, Mr. Vernon, the conflict of interest matter bothers me more than anything else. Gentlemen, I am troubled by this whole conflict of interest problem. Perhaps you may have know, I have been in business all my life, and I can't recall a situation where an industry has had as

many different regulatory powers as your industry has or wears as many different hats as your industry wears. I can't recall any similar situation where the same organization that runs an exchange also sets its margins, and allows its own board of directors to trade for themselves and for customers. There isn't even an electronic system to guarantee if each trade is made for a specific customer or for the trader himself.

It seems to me that your industry is fraught with conflicts of interest. I think that next year when we begin reauthorizing the CFTC, that conflict of interest will be the biggest problem we will have. In other words, how do we protect the integrity of the industry and of its regulatory bodies.

Mr. Berendt, I know you very well. I think very highly of your exchange. However, wouldn't you and Mr. Wilmouth and Mr. Vernon, welcome fewer opportunities for conflicts of interest in your exchanges?

Mr. BERENDT. In response to some of the points that you raised, I would take exception to the implication that the people that serve on these boards lack the kind of integrity that they should have to be governors of the Exchange. My Board in particular is comprised of 25 members from many phases of the industry. In addition we would include Andrew Brimmer and William Simon, who were public members during this period. I think these are people whose integrity cannot be questioned.

The other members of the Board are all members of senior management of member firms of the Exchange, of the floor brokerage community, and the metal trade. They accept their responsibility and understand their obligations very well.

They are very conscious of their position, both as members of the Board of the Exchange, as well as members of the metals community.

Mr. RICHMOND. I hate to interrupt you. Don't you think those people would welcome some of this responsibility being lifted from their shoulders?

Mr. BERENDT. Well, I can't speak for them, but I would say that none of them have voiced to me the desire to be relieved of this responsibility.

You mentioned that our industry allows people to trade for both customer and their own account and that we have no electronic means of reconstructing transactions. We have said time and time again that we can reconstruct transactions that occur in the market to a degree that we believe is sufficient for self-regulatory purposes and that at this point there appears to be no method of electronic recording that would not inhibit trading.

In addition, we believe that the marketplaces have functioned well. You said yesterday that the board of the stock exchange, and the securities industry in general, does not have the same problem of potential conflicts. We don't believe this is accurate.

The stock exchange board has 10 public members and 10 industry representatives. The industry representatives obviously are dealing with the same issues that our industry members or representatives deal with.

The public members in many cases are officers of companies whose stocks are traded on the stock exchange and, therefore, it

could conceivably be said of them that they have a conflict as well. In conclusion, we believe that our members have acted responsibly, and that any additional restrictions on them is not called for.

Mr. RICHMOND. Mr. Wilmouth.

Mr. WILMOUTH. I would like to respond to that also if I may.

I think Mr. Richmond, one of the points I would like to make is, we think the first line of defense we have against any impropriety that might occur is diversity of our directors.

As you know, we have three public directors and I include myself as a non-member as a fourth public director, and you are talking about the likes as I said before of a former Attorney General of the United States, Ed Levy. You are talking about a former retired chairman of General Motors, Jim Roach. You are talking about a distinguished professor of economics, George Stiegler; the chairman of the International Harvester Co., Harry Bircher; the public directors. That is point No. 1.

Point No. 2, three of our directors must reside a minimum of 50 miles outside of Chicago and that again gives us an ability to keep away from all of the concentration in Chicago.

No. 3, two-thirds votes must be taken by a board of directors for any emergency action which is really what we did in silver, and that is important to remember.

The next point, any of our actions that we take under emergency powers are only good for 30 days, and we must follow it up immediately thereafter with a detailed presentation to the CFTC who can then reject that action after a period of time if they so desire.

Finally, of course, there are very severe civil and criminal penalties for any impropriety on the part of anybody on our board of directors who acts in an improper fashion.

Mr. RICHMOND. Thank you. Doctor, I am sorry we have another vote on the floor. We will just have to adjourn the meeting until Chairman Jones returns.

Mr. Coleman, why don't you proceed?

Mr. COLEMAN. Because of the voting schedule, I haven't caught all your answers or all of your testimony. I apologize, so that if I repeat something that has happened before, please bear with me.

Yesterday some of you were present and if you weren't present I will put in synopsis form, Chairman Stone, in his remarks, said that one of the things that was most fearful to the Commission was the potential of financial institutions involved with the loans to the Hunts and others of being close to financial collapse.

Did any institution lending to the Hunts or somebody in the commodities market come close to financial collapse? Would any of the gentlemen at the table there have personal knowledge of that and have you heard of such a thing?

Mr. WILMOUTH. Let me, if I may, Mr. Coleman, comment a little bit. I am a former banker. I served 25 years ending up as executive vice president and director of the First National Bank of Chicago, this country's ninth largest bank. I was president of this country's 13th largest bank for a period of almost 3 years.

Let me tell you in very brief synopsis if I can what happened with respect to silver, for example, and these hues and cries about financial collapse being imminent.

As a former banker. I look to the bottom line. Some people lost money; some people made money; some market judgments were right. Some market judgments were wrong. No defaults, no brokerage firms collapsed, no customer money was lost other than through market moves. No banks failed. The established lines of credit served their purpose. The market remained open at all times. I find it hard to believe that the financial fabric of this country was in danger as a former banker. Yes, there were some brokerage firms that we watched very carefully. Mr. Berendt's investigative staff and mine were together over a couple of weekends taking a look at brokerage firms to make certain they were sound financially and if we felt we had a problem with them we called for additional capital to be brought in through the clearing organization and they all responded accurately. Nothing happened that I could see to cause this concern that seems to be expressed.

Mr. COLEMAN. If member firms of your exchanges require that if one of them were to be close to financial collapse, would in fact affect their status, and your exchange? Is that correct?

Mr. WILMOUTH. Well, I am not certain I get the total thrust of your question, but all of us have clearing corporations, some of them formed a little bit differently than others, and if there was a total collapse of one, then we have a clearing corporation to protect the integrity of the other members.

Mr. COLEMAN. So there is a need to know on your part?

Mr. WILMOUTH. Yes. We monitor very carefully and closely.

Mr. COLEMAN. And your need to know is a self-interest need to know.

Mr. WILMOUTH. Yes, to protect the integrity of the marketplace.

Mr. COLEMAN. So I would assume you would have gone out and found somebody if they were close to financial collapse.

Mr. WILMOUTH. Yes, sir, I believe we would.

Mr. COLEMAN. It is in your self-interest and you haven't discovered any or any of the other gentlemen who are here today have discovered any.

Mr. YEUTTER. May I comment, Mr. Coleman? We were not involved in that situation, so this is simply a philosophical response to your question, but in my judgment, Mr. Coleman, had any of those brokerage houses failed because of their alleged errors in business judgment, it seems to me that that should be construed by the Congress and by all the rest of us as a part of the workings of our free enterprise system.

Now, one could perhaps make a Chrysler kind of argument, that there is some public interest rationale of keeping that from happening.

I don't happen to share that viewpoint and it seems to me that there has been much too much concern expressed about that, on that issue, particularly when the facts don't even bear out the alleged dangers.

Mr. COLEMAN. I asked the question yesterday to the brokerage houses, and nobody responded with an affirmative answer. I have asked all of you gentlemen the question today and there has not been an affirmative answer.

The only person who has testified before us is Commissioner Stone who stated this, and he won't give us any particulars. I

understand if the specific names would be mentioned that it would have an impact on their stock and so forth, but he couldn't come up with more than one name which was Bache, and they denied it when their representatives up here at the hearing table, so this was part of the stampede into action, and I haven't found anybody yet in the entire world who will support the Chairman's position on this.

The gentleman from Comex, you said that your exchange would prosecute violation of exchange rules. What penalties are involved in such prosecution? I assume you don't mean prosecution in the sense of criminal prosecution. You don't have authority to do that. You have authority to kick him over and fine him?

Mr. BERENDT. Under the exchange by-laws and rules, disciplinary proceedings are conducted by the exchange through the committee process. Members who are found to be in violation can be fined in an amount up to, \$25,000 for each violation, and can be suspended, expelled, censured, what-have-you. Those are the kinds of actions that can be taken by the Exchange.

The investigations that we are talking about now are directly related to the position limit rule, and violations of the rule that may have occurred.

Mr. COLEMAN. Let me ask the gentleman from the Kansas City Board of Trade, you mentioned in your testimony about the closing of the markets immediately after the curtailment of sales to the Soviet Union in January, but you put it in pretty objective terms.

Let me ask you your opinion. Do you think the CFTC should have closed the markets those days?

Mr. SCHMID. Mr. Coleman, we at the Kansas City Board of Trade did not have anything against the CFTC closing the markets at that time. We would have thought that they would have closed also the exchanges that are contributory to grain markets, such as the produce markets, meaning pork bellies, generally the meat and articles like this, soybean meal, soybean oil.

Mr. COLEMAN. Also in your testimony on page 7 you state, "The CFTC lacks the necessary experts to deal with the issues."

I am befuddled and shocked to find that we have an agency that is in existence for at least 6 years, and receiving some \$14 million in appropriations who does not have the necessary experts to deal with the issues, and you go on further and say, "The inexperienced CFTC staffer," can you elaborate on that?

Mr. VERNON. Let me answer that if I may. I deal with it on a daily basis. It is more a problem of a learning curve, a learning process.

We are not trying to say that people are not educated or intelligent, that they are well-meaning. They are all of that, but there seems to be a constant learning process involved in change of people coming and going even at the Commission level.

We now have a vacancy. It is more the problem of lack of knowledge about the industry that continues to be a turnover problem all the time.

Mr. COLEMAN. That is what I assume we are concerned with is their lack of knowledge about this particular industry. It was pointed out that there is a vacancy and that the Chairman himself has had a year, I suppose, of experience in the field.

Let me ask, gentlemen, is there any alternative to either putting in place higher margin requirements or position limits in order to cure or limit the speculation or volatility of the markets? Is there any other alternative to this?

Mr. YEUTTER. Mr. Coleman, I appreciate a chance to respond to that because your question has an inherent premise that there is a need for curbing speculation. I don't happen to agree with that. I haven't seen any evidence in the silver situation or any other futures trading situation which suggests that that is the case.

There have been assertions that that is the case by some of the people who have testified, but I do not concur with those assertions.

Mr. COLEMAN. Don't imply my position in the question, just what the question was itself.

Mr. YEUTTER. All right.

My response is that in view of the fact that I do not believe that we are experiencing excess speculation, then there is no need for additional authority either in terms of margins or position limits. Now, we already in the exchanges, of course, have that authority. I am talking about additional Federal authority. We have that authority in the exchanges. If we do our jobs properly, Mr. Coleman, I see no reason whatsoever for going beyond that.

Mr. COLEMAN. But there is not even a third alternative for you to exercise. In other words, those are the two elements that affect the market.

Mr. YEUTTER. We have a lot of other regulatory steps that can be taken, Mr. Coleman, and those, of course, can be taken in varying degrees both formally and informally.

For example, on my exchange we very rarely apply—rarely is an overstatement, but it is only on a particular occasion and persuasive occasions that we increase margins to minimize the risk of price manipulation, for example, or we make a deliberate decision to alter or impose position limits for that purpose.

We generally become involved in a much more informal way in that kind of regulatory activity, particularly during the delivery month.

In other words, we jawbone rather than take formal actions of this kind, and that is really probably a much more effective way of doing it.

Mr. COLEMAN. Thank you.

Mr. GLICKMAN. Mr. Baldus.

Mr. BALDUS. Thank you, Mr. Chairman.

I have a question for Mr. Corn relative to his statement, but it sort of follows on Mr. Richmond's interest in conflict of interest.

You said in your statement on page 5 that the Board members excuse themselves. We have some problem, of course, with public confidence. That is one way to say it.

The Board members excuse themselves. Is there a pattern that requires that? Is there a rule that requires members to excuse themselves?

Mr. CORN. We don't have a specific rule in our book, but at all our Board meetings we have counsel present, and these are the guidelines that the Board follows.

Mr. BALDUS. The Board members follow?

Mr. CORN. Yes; we would get the benefit of their knowledge of the particular situation at the time that the Exchange Board decides it has to take a vote on action.

Those parties that have a direct interest in the particular matter before the Board will then excuse themselves. We are basically talking about market-type situations involving any one of our three contracts where we may have to take an emergency type action.

We are not talking about legislative actions. We are adopting a rule or a bylaw to put before our membership or put down before the CFTC where we are adopting a rule that will stay in place for some future date when we change it.

Mr. BALDUS. Are minutes of these kinds of meetings maintained?

Mr. CORN. Yes; they are.

Mr. BALDUS. Are they made public?

Mr. CORN. They are not made public, but there is a process where the members can have access to the rules.

Mr. BALDUS. Are they available to the CFTC?

Mr. CORN. Yes; they are.

Mr. BALDUS. How is the public member named, elected, appointed?

Mr. CORN. Yes; he is nominated by the Board. Currently our public members are the president of the Baruch School of Business in New York—

Mr. BALDUS. The school of business?

Mr. CORN. Yes; he is president of the school.

Mr. BALDUS. He is a highly respected academic member, but he doesn't necessarily have a contrary point of view. Since he is appointed by the Board, let's say that you are Mr. J. Q. Public, you could say well, he is sort of a house public member.

Mr. CORN. Oh, I would say he has had contrary points of view. He votes his conscience on all issues.

Mr. BALDUS. I thank you.

There is a matter of larger public concern and I would address this to each of the panel members. That is, during the period of time—and I am pretty sure you are going to say that the market was responding to inflation—many people think that there was quite a lot of money that was pulled out of availability because of excessive speculation in the commodities market. Speculation that has grown very rapidly over a period of years, the amount of trades that have occurred plus the amount of holdings.

I know that you can say because it is only the margin amount that there is not an awful lot of money, but then the Hunts go to the bank and borrow more than \$1 billion to sell out. When we asked questions here they said, well, they really don't owe anybody, and it is hard for the public to figure that all out.

At the time that this speculation grew very rapidly, the money supply was getting shorter. Interest rates went up. Inflation was growing very rapidly, and at least some people think that maybe it was because of an unbridled speculation there, an uncontrolled speculation in some commodities. Since that bubble has burst, why interest rates have gone down some. More money has become available. I guess I have talked long enough. I can see you are ready to respond.

Mr. WILMOUTH. If I could give a two-word simplistic answer to what you are talking about, Mr. Baldus, I think the answer would be stop inflation.

I think it is very true that a number of people went into the metals market, gold and silver in particular, and went into it because they were concerned about the value of the dollar, and they were attempting to get a better investment vehicle for themselves.

The other point that I would like to make before turning it over to my fellow panelists is that if you take a look at the period beginning, I may be over a few days, beginning about September 26, 1979, open interest, which is the amount of unresolved contracts that have not been matched off in the futures market in silver went down from about 186,000 until some time in January in the 28,000 range and then consistently went down below that so I can't necessarily say there was excessive speculation in the silver market at that particular period of time, but I do believe that people did go to the silver market, and use it as an investment vehicle, and that is both the cash market as well as the futures market because of inflationary pressures, and the answer to that has got to be as overly simplistic as it is, stop inflation.

Mr. YEUTTER. I would just supplement that, Mr. Baldus, by saying that clearly to the degree we have had additional speculation in some commodities, it has been both in the cash and futures markets, and it has been basically in commodities that are intangible.

People have fled from the so-called intangibles to tangibles. They do that when they are very uncertain of economic conditions facing their families or economic conditions facing the world or the Nation.

We have gone through a lot of that over the last year, as you well know, with Afghanistan, Iran, rise in prime rates and so on. When that occurs, people inevitably shift into something in which we have more confidence, whether it be—

Mr. BALDUS. We know so few of these contracts are delivered, do we call that a tangible?

Mr. YEUTTER. It doesn't make any difference, Mr. Baldus, because they have the right to call for delivery if they wish.

Now, if the implication of this question and the implication of some of Mr. Stone's testimony was that there is excessive speculation in commodity futures markets, over and above what occurred in the cash markets, there just is no indication that one has been out of line with the other.

The speculation, if there be any, has occurred in both.

Mr. BALDUS. Trying to control inflation, of course, what you try to do is take the speculative portion of the market out somehow or other, and, of course, admittedly in this kind of a market there is speculation. That is the purpose of many of the traders, is pure speculation.

Mr. YEUTTER. Certainly it is necessary.

Mr. BALDUS. And so we have rationed credit. We have controlled credit. We have moved in other sectors of the economy to do things to control inflation, but you say that you ought to be immune from

that. There are some sectors of the public I presume that needs further justification.

Mr. YEUTTER. Yes, I do not believe Mr. Baldus, that commodity speculation contributes to inflation. Mr. Stone believes that it does or has. I do not share that viewpoint.

Mr. WILMOUTH. May I add no more than speculation in the stock market, speculation in real estate, speculation in buying oil paintings, which went up tremendously during this period.

Mr. YEUTTER. We have moved to change the rules on some of those things. In other words, in credit ratings there.

Mr. WILMOUTH. How do you manage to control speculation in the oil painting industry?

Mr. BALDUS. I beg your pardon.

Mr. WILMOUTH. Just a rhetorical question.

Mr. BALDUS. It is my job to ask the questions.

Mr. WILMOUTH. I am asking a rhetorical question.

Mr. BALDUS. I ask the questions.

Mr. GLICKMAN. Mr. Fithian and then Mr. Wampler.

Mr. FITHIAN. Mr. Wilmouth doesn't control an oil painting speculation.

May I clarify one thing at the outset. I believe I did not misunderstand Mr. Schmid's question. I think what he was requesting of the committee was an opportunity for the Kansas City Exchange to respond in writing to the list of questions which are rather devastating in nature that were asked this morning by Mr. Walsh; is that correct? You were asking permission to respond?

Mr. SCHMID. Not only by Mr. Walsh but also about some questions that were asked yesterday, but you are correct in your assumption.

Mr. FITHIAN. May I ask unanimous consent of the committee that each of the exchanges, or the representatives, be invited to respond to those questions which were raised this morning, and any other questions which have been raised during the hearing that were not anticipated when they prepared their testimony.

My reason for that unanimous consent request is that I think we ought to have available to the committee and to the American people a rather full addressing of these items.

I have no way of judging; some of these questions seem particularly inflammatory, and it would be harmful to the Exchange to allow these to stand as though there were no answers to them, if indeed there are answers to them, which I suspect is the case.

May I make that unanimous consent request?

Mr. GLICKMAN. Without objection, the committee makes that request to the Exchange to answer, I believe, your request was specifically the questions Mr. Walsh asked.

Mr. FITHIAN. I am referring specifically to the questions in the Walsh testimony, pages 3 and 4, but if there are, or were other questions raised in the course of the proceedings that they would like to address because we are getting on down to the end of the day with all the interruptions we have had, I would open end the question a bit.

Mr. WILMOUTH. I have taken a quick look at those questions; I would be happy to respond to them now, or if you prefer submit in writing the responses to those questions.

Mr. GLICKMAN. I think, Mr. Wilmouth, it would be better in writing in my judgment.

Mr. FITHIAN. I defer to the committee. I was pretty sure Mr. Schmid was asking that question, and I don't believe that was the way it was interpreted.

Mr. GLICKMAN. Without objection, the committee makes the request that those questions be answered in writing and from the affirmative nods I would assume that the Kansas City Board of Trade, the Comex and Chicago Board of Trade nod their heads. I don't know if anybody else is relevant to those particular Walsh questions.

Mr. VERNON. Just questions in general. Five people can't respond to every question on conflict of interest, et cetera.

Mr. SCHMID. We appreciate that, Mr. Fithian.

Mr. FITHIAN. I was inviting them to do that and to hold our record open for a certain period of time.

Well, let me move to one question with Mr. Wilmouth; perhaps somewhere along the way we have had this explained.

I have been here throughout almost all of the hearings except this morning, and I think it might be helpful to the committee, Mr. Wilmouth, if you would explain briefly what you mean on page 6 where you indicate, self-regulatory actions taken by the board of trade chronicled in my detailed statement, et cetera; in essence these steps were taken for two reasons: One is the one I thought that you might like a moment to expand upon, to assure that brokerage houses, and their customers, had adequate financial protection during the period of extreme price volatility.

My question is one of information only, and that is how do you assure that your customers have adequate financial protection during this period of extreme volatility? The process is what I am seeking.

Mr. WILMOUTH. First of all, in the commodities business, customers' funds are segregated. When a customer puts up his margin money, those funds are put in a segregated funds account, and we audit that to make certain that is proper.

The other thing we did to make sure both the houses and their customers, because if the customers don't keep their margins up, eventually it is the responsibility of the member of the brokerage house, we wanted to be sure that those margins were met; and as we raised them it became more important to make sure they were secure.

We reviewed the records and in that way we were protecting the brokerage houses and their customers to make sure those funds were properly segregated and the raising of the margins ranged from \$1,500 to \$30,000 per contract.

That was a significant change, and we felt it was important to watch that. In addition, the brokerage houses themselves frequently increase those margins sometimes by twice that amount. We might be calling for a \$30,000 initial margin on the spot contract and they might be calling for \$60,000 or more, and if I remember correctly in one case they were calling for \$100,000 margin.

Mr. FITHIAN. The last question I have is for Dr. Yeutter. I was tempted to address him as Mr. Secretary.

It is just really a quick question. We have heard it both ways during these hearings.

Mr. Schmid says that the board should have acted earlier, that the exchange should have acted earlier. Witnesses yesterday were very, very strong in their opinions that the exchange acted too soon and some said they should not have acted at all. They should have let the market run its courses.

Is that a typical criticism when the exchange takes action on something that is pretty highly publicized and pretty well known throughout the industry? Are those sorts of attacks from the right and left or the top and bottom usual in the case when the exchange takes an action that is pretty definitive?

Mr. YEUTTER. I will answer in a general way and perhaps Mr. Berendt or Mr. Wilmouth would like to comment, since they are the exchange that was involved. I don't really want to second-guess my fellow exchange.

I would simply say we are almost always second guessers for any kind of regulatory activity, whether it be performed by the Federal agencies or by the exchange.

We get criticized too.

Mr. FITHIAN. Or commercial.

Mr. YEUTTER. My experience at the Merchantile Exchange, we almost always get some criticism, irrespective of what we do or do not do. It's a matter of trying to balance interest, as you know. There are never any black and white situations in the regulatory arena.

It is always some shade of gray, and the responsibility of the chief executive officer or the business committee with the Board is always attempting to balance the interests, protect the public interests and the interests of the customers, and that is a very difficult call to make sometimes.

With respect to the silver situation, from the sidelines, my general reaction is that, everybody did a pretty darn good job, and that I really can't see how the exchange or the CFTC could have been much more thorough in their analyses than they were in that situation, so I am a bit impatient with those who second-guess either the CFTC or Comex or the Chicago Board of Trade with respect to the silver situation.

Mr. WILMOUTH. It is interesting to note, and I have to interject it here, both the Comex Exchange and the Chicago Board of Trade are both being sued by longs and by shorts, each claiming from his own market perspective that we did them in.

The longs are saying we did too much during this period and the shorts are saying we didn't do enough, and those two diametrically opposed theories have got to provide the price neutralities of the actions that both took.

Mr. BERENDT. I would add to that that each of us, the board of trade and Comex in fulfilling our self-regulatory responsibility, viewed the problem and possible solutions differently. We are governed by different boards. We are governed by representatives of the industry that have different views at different points in time on the most effective ways of handling a market situation.

The board of trade chose to do it in one form or another, and Comex chose a different route. We used self-regulatory tools we

had at our disposal, and did what we believe was right at the time. We continued to watch this situation on a regular basis.

We met 34 times in a period of 6 months. That is an inordinate amount of time to spend on a problem, and just the mere fact that the board members gave that kind of time to this situation is indicative of the level of responsibility that they accepted for dealing with this problem.

Mr. FITHIAN. I wanted to say that you had so many titles back upstream I didn't know whether to call you Mr. Ambassador or Mr. Secretary, from your former illustrious career in public service.

Thank you, Mr. Chairman.

Mr. YEUTTER. Thank you for the kind compliments.

Mr. GLICKMAN. Mr. Wampler?

Mr. WAMPLER. Let me say to my distinguished colleague, as far as the gentleman from Virginia is concerned, it would be particularly pleasing to me if he were to refer to Dr. Yeutter as Mr. Secretary.

Mr. FITHIAN. I hadn't noticed you were sitting over there.

Mr. WAMPLER. Let me express my appreciation to each of the witnesses for being here today and presenting testimony. It has been particularly enlightening to me and I trust to the rest of the committee.

This morning we heard from a distinguished panel of witnesses, one of whom was Mr. Walter Frankland, representing the Silver Users Association.

If I may, I would like to briefly quote from page 5 of his testimony. He said:

We recognize as essential the participation of speculators in silver futures to permit the conduct of a viable hedging market for use by producers and users of metal. This entails a delicate balance between regulations and liquidity in each market. We are most concerned that a failure to maintain reasonable restraints in the futures market could lead to other rounds of speculative spirals.

I share that, and I think that represents a lot of thinking of members of this committee, and I would assume it does represent those of you that represent the various boards of exchange. If I may, I would like to pursue for just a moment the line of questioning that was being followed by the gentleman from Indiana.

It is my understanding that the Chicago Board of Trade and Comex set different position limits on silver and set them at different times.

Now, I assumed that your determined that some limit was necessary and if special limits in silver are needed, is the effectiveness diminished by having different levels of the two major exchanges?

I guess it would be appropriate to ask representatives of those two exchanges to respond.

Mr. BERENDT. In response to your question, since there are two separate markets and people can use each separately, they have the ability to trade within the limits of the two exchanges.

The Comex board considered position limits, or the advisability of position limits, on several occasions prior to the ultimate date of their imposition on January 7.

Each time they were discussed, prior to January 7 the board came to the conclusion that they were discussed they were not appropriate or necessary.

The board came to the conclusion that position limits should be selected after as a result of discussions with members of industry and members of the silver trade in order to establish limits which would allow them to operate within the marketplace, allow them to hedge, and allow people who were interested in speculating in the commodity to do so within a limit that the industry or the trade could handle.

We looked at the annual production and at the available silver that would be in the marketplace which would be deliverable and selected a number.

The process was one that was based strictly on an understanding of the industry and how people wanted to work within it. I don't know what the criteria the board of trade applied to their limits, but they clearly adopted a much lower level than the Comex board determined.

Mr. WILMOUTH. We did come to a lower level and we came to it a good 2½ months, I believe, before Comex did. The markets are somewhat different, and we reacted differently. Comex basically at the height of the silver market had about 60 percent of the silver futures market and we had 40 percent. The Comex market is more oriented to foreign participation than perhaps we are.

The Comex market is more commercially oriented in the composition of the members of the board. As to the way they decided to make judgment decisions to attack the problem, all of us reached different conclusions.

They raised margins to a higher level at times than we did. We might have felt that we had dimmed the potential problems by taking action earlier. All of those factors enter into it, but the main fact is I think we all took some decisive action we felt was necessary to control and maintain the integrity of the marketplace.

Mr. VERNON. Sir, everyone always says there is too much speculation in the market, but we have to look from whence they come. The testimony was very instructive this morning.

Mr. Frankland, allegedly representing a consumer group, Silver Users Association, was unhappy with speculation, because prices went up. The grain farmers before your committee weren't happy with speculators because prices went down.

We can't have it both ways. You can't blame the speculators for putting it down or up, or else you have to give them the credit. It's the market that decides the price, not the speculator.

It is very important when we make our analysis to be careful not to damn the market until we see who is making the cry that is going against my interest.

Mr. WAMPLER. I appreciate your comment and, as I tried to express earlier today and yesterday, I have some serious reservations about the whole regulatory scheme, but if we have it in place we want to be sure that what has been done and what has happened is a result of reasonably natural market forces and has not been the success or result of manipulation of the billing.

One final question: Were position limits that were applied by Comex and the Chicago Board of Trade applied retroactively and, if so, when were they?

Mr. WILMOUTH. Yes, sir; our position limits were applied on October 25 and what we effectively said to people is that in your

entire positions, you cannot be net long and short more than 600 contracts. Initially, we said by February 1, and then we extended that until April 1, so we told them on October 25 and they probably got the word on October 26, you had until that date to get down to that number.

Mr. BERENDT. On Comex you have to look at two different types of positions; positions to be established and existing positions. For existing positions we adopted the rule and made it applicable effective February 18, with the requirement that within 1 year the positions must be within the guidelines established by the board.

However, we required that anyone in excess of the position limits which were permitted must reduce their position by 10 percent per month in order to be in conformity with the rule within the 1-year period.

Mr. WAMPLER. I request that the witnesses do submit replies in writing to some of what I perceive to be rather serious allegations raised today, because I don't think it would be fair to let the record stand.

Mr. GLICKMAN. I think the record indicates they have agreed to do so.

We will go through the committee one more time.

Do you want to go first?

I am the acting chairman. This is my real boss, Mr. Jones.

Mr. JONES of Tennessee. I have a couple of questions, maybe three I would like to ask. Let me ask this of each of you. Do any or all of your exchanges have the authority to ban the Hunt brothers from using your markets?

Mr. WILMOUTH. I don't believe we do, sir; no.

Mr. YEUTTER. Only if they were engaged in conduct under our rules; oh, that is right, they have to be members. Were they members and were they engaged in conduct under our rules that would qualify for that kind of sanction, then, of course, they could be removed but only under those circumstances.

Mr. WILMOUTH. I would like to point out in the particular case that you talked about, that the Hunts are not members of the Chicago Board of Trade or, for that matter, of Comex, and that they dealt through futures commission merchants, or a major brokerage house, such as Merrill Lynch.

All of our initial dealings went through our major houses, and although I had numerous conversations with the Hunts regarding their intentions, they did it all voluntarily. We had no control over it, but I want to emphasize that they did voluntarily cooperate and talk with us with respect to their intentions.

We could not ban their participation. If they violated the Commodity Exchange Act, we would have, of course, banned them from participation in the futures markets.

Mr. JONES of Tennessee. Does that apply to all of you?

Mr. BERENDT. Yes.

Mr. VERNON. The CFTC might have authority, if you manipulate or organize a Federal crime.

Mr. SCHMID. If their positions would be non-reportable, we couldn't do anything.

Mr. JONES of Tennessee. How is that?

Mr. SCHMID. There is a limit up to which a position worked through an FCM is not reportable. We would not know how it was necessary.

Mr. JONES of Tennessee. One final question, Mr. Chairman.

Do any of you feel, and this is a very important question to the subcommittee, do any of you feel that even though the Hunts may not have broken any laws that they are simply too big an economic force for us to deal with?

I am referring to my subcommittee, of which I am a member, and the CFTC and everybody else. I want you to be honest and frank with me.

Mr. BERENDT. I would respond to the question by saying that the activities of the Hunts in the market were not a new event, not a new activity, not something that occurred over a very short period of time and developed overnight.

Many of you will recall that the Hunts began to become interested in silver back in 1973 and 1974 and I can recall that there were several questions asked during the original authorization hearings about the Hunts' activity.

They were active in the market during reauthorization; they have been known to the exchanges and the CFTC for quite a while. Alone, their positions were not too large for the marketplace. Events happened in the marketplace to change what had existed.

There was the introduction of new individuals, foreign interests, in the silver market. Also people were buying silver not only through futures, but in the cash market.

In addition the economic situation changed dramatically, affecting their ability to operate within the marketplace. Therefore, to say are they too big for us or the market, is not necessarily true. However, given all of the events that occurred their position, and others began to cause not only them, but along with others, cause difficulty.

Mr. WILMOUTH. If I may, I should preface or perhaps qualify my answer with a statement that I have known the Hunts indirectly and directly through other business dealings when I was in the commercial banking business for well over a decade and a half, I believe it is, and I have always found them to be very honorable and very trustworthy businessmen.

The second point is we have dealt with them at the board of trade, even prior to my joining the board of trade, in various commodities and have had occasion to discuss with them participations in other markets and, again, in all of those other markets, at least from the standpoint of the Chicago Board of Trade, they have acted in a very honorable manner and behaved properly.

I must also go on to say during all of the conversations, and there were numerous conversations in the months of October and November that I had with the Hunts with respect to what was going on in the silver futures market, they were very responsive, and when they told us they were going to do something and said they were going to do it if it wasn't uneconomic, they did it, and I would have no quarrel with their behavior insofar as following the technical rules of the board of trade.

I don't believe their participation disrupted the market or that they are too big to participate.

Mr. YEUTTER. I have never dealt with the Hunts, so I have no comment on that specific case, but again I would like to respond in a general way.

Whether the Hunts be involved or whether it be General Motors in the automobile industry or MacDonalds, in fast foods, I have never been of the view that size per se is sinful. It seems to me the question is one of in this case a market conduct rather than size.

I would have no concern about the Hunts trading any of the commodities on our exchange. I would be just as concerned about their conduct as I would about the conduct of any other member, but we would treat them just the same, and it seems to me that there is ample authority to handle their market conduct or anyone else's market conduct in an effective way.

Mr. JONES of Tennessee. My time has expired. Thank you, gentlemen.

Mr. GLICKMAN. First of all, I think I asked you this the last time you were here, having to do with self-regulation, and yesterday morning both Mr. Baldus and I told the CFTC that we expected, and we also told Bache Halsey Stuart and Shields, E. F. Hutton, that we strongly expected a title III self-regulatory apparatus to be in effect as quickly as possible, because that is the best way that you can convince us and the public that at least your relationships with the public are, again, self-dealing and against all sorts of activities which have been fairly well handled in the securities industry under self-regulation move ahead, and I would urge you strongly to move ahead with that.

I assume you are. I am going to bird-dog you on that one.

Mr. WILMOUTH. I would add we were one of the original founders of the NFA, and have contributed to it, and we have been following it very closely. We think there may be other ways to do it, but we are certainly following that very closely.

Mr. GLICKMAN. Yesterday somebody made the comment to me, well, they are ready to go ahead with it; but the Chicago Board of Trade is where it is being stalled right now.

I mention it to you because it is important for the public who buy futures to have some what I call reasonable degree of standards in terms of how they are dealt with by FCMs and people in the industry, and it looks like self-regulation is the way to go.

It works pretty well in the securities industry, and it is the same people buying futures as buy securities.

Mr. WILMOUTH. We are carefully studying it.

Mr. GLICKMAN. Would you classify the Hunts as speculators or hedgers?

Mr. WILMOUTH. Speculators.

Mr. GLICKMAN. Are any of you aware that they are large, that they have large positions in futures and Treasury bills and Federal securities, government securities?

Mr. WILMOUTH. I understand they participate in other parts of the market, yes, sir.

Mr. GLICKMAN. Would the silver situation have been avoided if in the daily settlements the Hunts could not have taken their profits out of the market or at least until their contracts matured or were sold; these sums were reinvested, and wouldn't an action

along the type I am talking about have prevented some of the extreme volatility?

Mr. YEUTTER. May I respond to that one, because I have given that one some thought in the last few days in the light of the Proxmire legislation.

That is nonsensical, Mr. Chairman, because there is no more rationale for precluding an individual from using profits that are available to him from the futures market to invest elsewhere or again in the futures market if he wishes. The pyramiding question is what you are alluding to, and it is to preclude him from using those profits to buy a house or a piece of real estate or a diamond ring.

Mr. GLICKMAN. In the Hunts case, their margins were being financed by either the brokerage firm or some banks. Now, don't you think we need to have some kind of rule that would prohibit that kind of situation then?

Mr. YEUTTER. No; I do not. I don't see what difference it makes how those margins are financed, directly or indirectly. It seems to me the only public policy question here is whether this led to excessive speculation or price distortions or some other conduct that would be indefensible in terms of public policy, and I do not find that to have occurred.

Mr. GLICKMAN. I would like to ask two more questions.

This is an unrelated question to Mr. Wilmouth.

Is it true that the Soviet Union is directly or indirectly trading grain contracts, futures contracts today on any of the Chicago Board of Trade?

Mr. WILMOUTH. To the best of my knowledge, I don't know of them doing any direct trading at all. To the best of my knowledge, I would have to answer that question no, sir.

Mr. GLICKMAN. Mr. Schmid?

Mr. SCHMID. I have the same answer.

Mr. VERNON. It is possible that some other governments may be from time to time hedging, which is a very normal, natural use of our market. In Chicago, too, they are world markets today.

Mr. GLICKMAN. Do you have any figures as to the effect of foreign governments hedging on our futures markets? Do you always know when a foreign government is hedging?

Mr. WILMOUTH. Not always; no, sir.

Mr. GLICKMAN. Finally, I would ask a question, in the Bache Halsey Stuart testimony, Frederick Horn yesterday, I quote the testimony, you may have it, Mr. Wilmouth.

When the Chicago Board of Trade proposed regulations imposing retroactive position limits in silver futures contracts in December of 1979, we expressed our strong opposition to such limits. Nevertheless, the CFTC approved the proposed limit and allowed them to be imposed retroactively.

We think not only was this undesirable but it illustrates what may be an anomaly that occurs in various areas of the rulemaking authorities of the Exchange. We doubt that if the CFTC itself were to adopt rulings concerning position limits that it could in all cases adopt them to have a retroactive effect. This is a result of concepts of due process which limit rule-making of government agencies.

I wonder if you might comment on that statement by Mr. Horn?

Mr. WILMOUTH. Well, I would say first of all, that I think Mr. Horn and members of the board of trade, commission houses, and the like, are fully aware of the powers that we do have, and we do have emergency powers which would allow us to do that. We passed that emergency action. We had it for 30 days, and remember it didn't take effect until February 1 initially, and then April 1.

The CFTC had the right and the authority to turn it down, but our emergency action was blessed by the Commodities Futures Trading Commission and I believe, in fact I know, that Mr. Horn is well aware of the fact that that action was a permissible one under very dire emergency circumstances.

I would also point out that it is very seldom that we go to the extent of doing something as dramatic and as drastic as that, and I think the same thing is true of other exchanges. We use that power very sparingly.

Mr. GLICKMAN. Thank you.

Mr. FITHIAN, do you have any more questions?

Mr. FITHIAN. Just two, Mr. Chairman.

Mr. Wilmouth, you don't have to answer this if you don't want to. There is an awful lot of criticism that I have heard, at least out our way and here in town, of the Fed, for not having discouraged the \$800 million in loans from the banks to the Hunts. The argument runs that they were in the market speculatively, a lot of other people got hurt. Why shouldn't they take their lumps. If you had been a member of the Fed, would you have voted yes or no, if a motion had come up saying that the Fed should discourage the banks? I ask you this because of your former banking experience.

Mr. WILMOUTH. I will hedge, if I may, a little bit—

Mr. FITHIAN. You may hedge on the futures contract if you like.

Mr. WILMOUTH [continuing]. And tell you from my limited, and I emphasize the word limited, knowledge of that loan. I think I would not have blessed and approved it, but would have allowed it to go through, if I was a member of the Federal Reserve Board of course.

Mr. FITHIAN. The other question is really for all members here, and has to do with something as a member on this subcommittee in the past 4 years, though not this term, we had, as I remember, Mr. Jones, a number of people who got very nervous at the last time we went through the CFTC legislation, about the proliferation, as they called it, of new contracts, talking about contracts in the Dow Jones futures and the like. That is not all entirely clear to me. I have no particular position on this, but some have argued before this committee that that is kind of leveraging upon leverage, or it is somehow dangerous to the economy or whatever.

I know we have a number of new contracts now, contracts that were not in existence 10 years ago. There are a number at the Chicago Board. There are a number elsewhere. I would be interested in not so much the argument over a particular contract. That is not really what I am interested in. I am interested in this: I am interested in your best professional judgment as to the best arguments for and against the increasing of numbers of new contracts. I know that is not today's hearing but we don't get you guys together very often.

Mr. VERNON. Mr. Fithian, in 1973 the Congress stated in a committee report it was the intention of Congress that new and innovative contracts should be encouraged, and then they had the second statement that if there was a question regarding their economic suitability the market should be the test. That was very wise and profound, and the point is that when a market proposes a new contract, it is the only one that has invested time and money, and it would like to have the opportunity to let the public trade it, and if it has no economic purpose, it will not trade. It may sputter but it will not trade, and ultimately the only loser will be the market that invested its time and money in this new innovative system.

We believe that the American public and the American markets are very sound. They are very knowledgeable. They are very experienced, very sophisticated, and they will use markets that benefit them, and they will not use markets that do not benefit them. We think it is that simple.

Mr. FITHIAN. Anyone else want to comment on that?

Mr. YEUTTER. Yes, Mr. Fithian. First of all, one should recognize that this problem has been dramatically overemphasized. The concern about proliferation has been expressed by a number of Federal officials on a number of occasions. Yet, there has been nothing really to justify that concern in terms of that proliferation having occurred.

There have been a good number of contracts launched in the last several years, but it is interesting to note that not one has been successfully launched in about 4 years by any exchange, so the proliferation that everyone has been concerned about over the last 2 or 3 years simply seems to be one of fighting ghosts, because it is very difficult to launch a successful contract, and no one has done so in recent years. This isn't to say that we shouldn't try, and I hope we can launch some successful and innovative new vehicles, but the market will make that determination.

I find it difficult to comprehend why people are so reluctant to permit the market to function. My only hesitation in this regard is that if we have a lot of modestly successful or marginal contracts, they cause us all difficulties in terms of surveillance. It is much more difficult to provide surveillance and compliance activities in a program that is trading in marginal volumes than it is one that is trading in large volumes.

The risk of price manipulation is greater. The risk of price distortions is greater, and so on, so they are a headache for us administratively, if and when we have a proliferation of contracts that do not trade well. But aside from that, I have seen no public policy concerning service in terms of proliferation damaging the deliverable supply and impeding debt management efforts and so on.

Mr. FITHIAN. If I may just inject for the benefit of anyone else, one of the arguments that I remember coming up in the committee was that if we get—that is, in the commodities, if we get into reaching out so far from what are normally considered commodities—that there would be a very good argument for either proliferating jurisdiction in the Congress, that is, letting the Banking Committee take over T-bills, Japanese yen, et cetera, or some other division.

My own judgment is, and it is not one just of turf here, but I think one committee ought to deal with this in the Congress. I feel very strongly about that, and I just wanted to alert you that that is one part of that argument which hadn't been alluded to here, and perhaps from your side of the table that doesn't seem to be as much of a danger as I see it here, but I think my tendency is to believe we would be ill advised at having more than one regulator.

I don't know that much about regulation. I know that much about Congress. We would be ill advised having more than one committee dealing with this issue in Congress. We have some areas where we have that kind of overlapping jurisdiction. We haven't been fantastically successful.

Mr. WILMOUTH. I would like to comment briefly, I would thoroughly agree with what you say. We would support jurisdiction in one agency. I think the answer in doing it that way lies in the fact that what you are policing in this business with a Federal governmental agency is you are policing a function. You are not policing products. You are not policing a specific commodity, whether it is a Treasury bill or it is a contract in beans. You are policing the function of the futures markets, and that function can be policed by one agency having tools of jurisdiction in a much better fashion than bifurcated, vertical, integrated, multiple regulation, or whatever you want to call it.

Mr. SCHMID. We are definitely of the same opinion, Mr. Fithian.

Mr. BERENDT. Mr. Fithian, Comex has always endorsed the concept that the regulation of our industry should stay with one agency, and stay with this committee. We have seen nothing to lead us to believe that that should change. I think it is very important to note when one talks about the development of new contracts, that we must pass an economic purpose test in order to be designated to trade these contracts.

Dr. Yeutter is correct when he says that the arguments about proliferation don't seem to be related to much that has happened over the past few years, because we haven't seen too many new contracts. If there isn't a need, a contract will not be approved. An industry or group that wants the contract has to demonstrate a need and show that they will use it.

If they use it, the market succeeds. I think that is the best test to determine whether or not it is needed.

Mr. VERNON. With all due respect, we find it quite ironic that in 1977 this same conversation occurred and we had a pending stock index contract. It is now 1980 and fast approaching 1981. We may have the same conversation next year, because it seems to us that the CFTC has shown no great proclivity to fast approval of new contracts.

Mr. FITHIAN. Thank you, Mr. Chairman.

I want to also thank the members for coming this afternoon. As I am sure everyone is aware, this is a terribly technical process. It is a difficult area in which to legislate, and we appreciate your sharing your expertise with us.

Mr. GLICKMAN. I just have one brief question before turning to Mr. Wampler. I asked a minute ago about the Russians buying grain. It has come to my attention that the Russians may have been buying silver directly or indirectly on one or more of the

exchanges. I wonder if any of you have any knowledge of this? I understand that our strategic reserve of silver is fairly small, and the Soviet Union may have been in the market, and may have participated in fact in the upward movement of silver prices. Do any of you have any information regarding that?

Mr. BERENDT. We at Comex have no information.

Mr. WILMOUTH. We are talking only about the futures market?

Mr. GLICKMAN. That is correct.

Mr. WILMOUTH. I would reiterate what Mr. Berendt said. None in the futures market. There may be in the cash market. That I don't know.

Mr. GLICKMAN. Mr. Wampler, do you have any further questions?

Mr. WAMPLER. Thank you, Mr. Chairman. I don't have any questions. I would like to make this observation. I would assume that CFTC is monitoring these hearings, and I am sure that copies of the testimony will be made available to them.

It seems to me it might be desirable for the committee to consider requesting that CFTC likewise respond to the allegations that were raised earlier today. It is my understanding that they do have current investigations going on in some of these areas, and of course they have the manpower and the data that this committee does not have available, and that we might want to ask them likewise to respond to certain allegations that were raised here this morning.

Mr. GLICKMAN. Do you want, as the committee, to ask the CFTC to respond to Mr. Walsh's questions to the extent that they can, or generally respond to the other questions that have been raised here today?

Mr. WAMPLER. I think it should be directed primarily to Mr. Walsh's testimony and allegations, but not limited to that. I think they are the more serious.

Mr. GLICKMAN. I don't know whether the CFTC is conducting an investigation. If they are, then there may be some problems with disclosing any nonpublic data associated with an investigation, but I think the suggestion is a good one. I think we can talk to them about it to see what they feel that they can disclose under a variety of privacy statutes.

I am going to let the chairman close, but I would just have to say that I have really appreciated these hearings. I have had some interest in the futures market for a long time. I still believe that it is an enormously growing industry, and one that not very many Americans comprehend very well. I agree with Mr. Fithian that this committee, one committee of jurisdiction should have exclusive jurisdiction as should one agency over futures.

I may disagree with you on some issues regarding level of entry for some people, but I am openminded enough to share ideas with you back and forward.

In addition, as I said before, I think it would be a helpful thing. Mr. Chairman, for members of the committee to visit some of the exchanges. I have been to the Kansas City Board of Trade, but I have seen the big Chicago Board of Trade Building from the outside on several occasions, but never been inside. I am sure Mr. Wilmouth would invite me there.

Mr. WILMOUTH. Love to have you.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman. I want to associate myself with the remarks you have made. I think it is good to have an opportunity to visit the exchanges. I hope except I have not been to the Kansas City Board of Trade. I hope to go sometime.

I need to say this to you gentlemen: We do appreciate more than you know the fact that you have been patient and have taken the time to be with us. I am sorry we had to abide by the rules that we did, but you see it has paid off, because we get through before the end of the session, at least. I know that doesn't bother anybody. The House is already out of session, and I am sure some people are waiting for the adjournment. You have done a good job and we are very proud of the fact that you came and cooperated with this subcommittee.

We need help. I think every member of this subcommittee realizes that. We realize we have a big job to do and a big obligation, and with the exception of Mr. Glickman, not one has had much experience in this field. He was with the Securities and Exchange Commission for a while. Outside of that, we have all been in a learning process for the time that we spend on the committee. We do appreciate very much your being here.

I need to ask unanimous consent, gentlemen and members of the subcommittee, for the filing of the Heifner report. I am not sure that I asked for that the other day. I would like to ask that you make it a part of the record, and any other report that we have here that staff and members feel should be placed in the record. There is a whole compilation of them there, and we may need to make part of them part of the record and part as exhibits.

Mr. GLICKMAN. Without objection, it will be part of the record. [The "Report on a Study of the March 1979 Chicago Wheat Futures Contract," by Richard G. Heifner, is held in the subcommittee file.]

Mr. JONES of Tennessee. The committee stands adjourned until next Thursday, May 29, at 10 a.m.

[Whereupon, at 4:45 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Thursday, May 29, 1980.]

[The prepared statements referred to follow:]

REMARKS BY

ROBERT K. WILMOUTH

PRESIDENT AND CHIEF EXECUTIVE OFFICER

CHICAGO BOARD OF TRADE

I am Robert K. Wilmouth, President of the Chicago Board of Trade. With me at the witness table today are Alfred H. Gruetzmacher, Chairman of the Board of Trade and vice president of Geldermann and Company, FCMS; and John H. Stassen, a partner in the law firm of Kirkland & Ellis, general counsel to the Board of Trade.

I want, first, to thank Congressman Jones for the kind invitation to testify. I do think I can shed some light on what I see as the central question posed by these hearings: "In view of recent events, particularly in silver, is the Commodity Exchange Act adequate to protect the public interest?"

My answer is a firm yes, and we have prepared for the record a detailed written statement -- over 300 pages of text, charts, and exhibits -- supporting our position. My remarks are but a brief summary of that detailed statement.

Turning first to silver, I must note at the outset that I did not become President of the Chicago Board of Trade until late 1977. The bulk of my professional life has been spent in the banking industry -- in Chicago, Europe, and in San Francisco, where I was President of the Crocker Bank. As a banker, I know all too well that our western economic system is interrelated and always influenced by political as well as strictly economic factors. As my remarks today, and our detailed statement, demonstrate, silver is no exception.

Some Facts:

Gold, and the "poor man's gold" -- silver -- have historically been viewed as hedges against economic and political uncertainty.

Historically, also, the price cycles for silver and gold coincide.

They did so during this recent period.

The price of silver increased substantially -- some 8-fold during a 12-month period, peaking on January 21, 1980.

So did the price of gold, which climaxed on the very same day.

After January 21, the price of silver decreased dramatically.

So did the price of gold.

* * *

I have been talking about physical, cash silver.

What about Futures?

1. During the period April 1979 through March 1980, Chicago, New York and London futures prices and U.S., London and Zurich cash prices moved in tandem.
2. During this period, there was no systematic tendency for futures to lead cash, or cash to lead futures.
3. Throughout this period, silver futures markets continued to serve their price-discovery and risk-shifting functions.

Why did gold and silver rise and fall? I suggest the following factors which are discussed at length in our detailed statement:

1. Inflationary pressures, followed by unprecedented credit restrictions and extremely high interest rates, and then by recession.
2. Changing perceptions of worldwide economic and political conditions, including the unfortunate situations in Afghanistan and Iran.

In sum, I believe that silver cash and futures prices rose and fell together, and in tandem with gold, because of worldwide market fundamentals, and not because of the actions of any individual or group of individuals.

This is not to say that these were easy or, in any sense, normal times. It is indeed unusual when a relatively small number of individuals desire to convert large amounts of paper currency into silver. The record will show that the Board of Trade took a number of self-regulatory actions during this period. Between September 5, 1979 and March 18, 1980, silver was discussed at 15 meetings of the Board of Directors of the

Exchange, 12 of which were emergency meetings. As a result of this daily surveillance and monitoring, the Board of Trade took margin or emergency action on 21 occasions. These silver actions fell into six categories.

First, we adjusted margins throughout this period, generally raising but occasionally lowering them when we thought that doing so was prudent and would provide more liquidity to the marketplace.

Second, on October 25, 1979, we adopted position limits limiting market participants to 600 contracts, net long and short, and ordering persons with excess positions to come into compliance by April 1, 1980.

Third, on January 22, 1980, we acted to prohibit new positions in the January, February, and March contracts and directed a compulsory phased liquidation of the existing positions in the February contract.

Fourth, during this period we expanded price trading limits several times in an effort to allow the futures to more accurately reflect the changing prices in the cash market.

Fifth, we changed trading rules relating to spread trading in an effort to improve the ability of participants to liquidate their positions in the market and to allow the market to continue to function as a hedging and price-discovery mechanism.

And sixth, when the price of silver broke sharply on March 26, we reviewed the financial positions of five of our firms continuously until they had liquidated their silver positions or no longer gave us cause for concern over their financial stability.

We had auditors present at one firm for six consecutive days and at another firm for seven consecutive days. Partly as a result of these audit activities, and audit activities conducted by the Commodity Exchange, Inc. and the CFTC, several of our firms were required to obtain additional capital.

* * *

There has been much public talk about "excessive" speculation. By March 31, total open interest had declined to

24,360 contracts from a level of 184,818 contracts on September 4. These open interest figures belie that theory. All positions, including speculative positions, were declining dramatically during this period -- as prices rose, and then fell. Evidently price volatility and the cost of maintaining adequate margins created a riskier situation than most speculators cared to incur. After September 18, 1979, speculators had to post initial margins of a minimum of \$30,000 to carry a position in the spot month, an amount sufficient to cover silver's price volatility and an amount which we think kept the small, poorly capitalized speculator out of the market.

All of the self-regulatory actions taken by the Board of Trade are chronicled in my detailed statement. In essence, these steps were taken for 2 reasons:

1. To assure that brokerage houses and their customers had adequate financial protection during a period of extreme price volatility.
2. To prevent large concentrations of speculative positions from being maintained in the market, or from entering the market, which the market could not reasonably accommodate because of limited deliverable supplies, changed delivery expectations, and general world economic and political conditions.

By both measures, I believe we succeeded.

I should interject here that our exchange has already been sued by both a long and a short, each claiming from his own market perspective that we wronged him -- the long saying we did too much during this period, the short saying we did not do enough. I think these two diametrically opposed theories confirm the price neutrality of our actions.

I should add that during much of this period, I was in frequent contact with major long participants in the market-place to ascertain their intentions with regard to their silver positions in Chicago. They continually assured us that they intended to behave responsibly and to move or liquidate their

positions in nearby months in an orderly manner. Based upon the information available to me, I believe they did so.

But we did not rely solely on these representations; the market is bigger than any one entity, and we had to act to protect it as a whole, which we did.

* * *

Much has been said about what the CFTC should have been doing during this period. We have had our disagreements with the CFTC in the past -- one of which concerns March 1979 wheat, which I shall discuss in a moment -- but in this matter, we believe the CFTC acted in a prudent and responsible manner. They recognized in this instance, at least -- as we always do in the performance of our regulatory role -- that futures regulators are not in the business of setting prices. The free market does that.

This does not mean that the CFTC was not monitoring the situation as closely as is humanly possible. We knew they were. We also knew they were monitoring us.

There was close consultation and cooperation. But when we took self-regulatory actions to preserve the integrity of our market, we did so because we were convinced that they were necessary and proper things to do, not because the CFTC had ordered or even urged us to do it. CFTC Chairman Stone acknowledged this fact last November in the New York Times.

The CFTC could have acted, of course. They have a strong array of remedies at their disposal. But any such action was clearly unwarranted, in view of the actions we had taken, and the fact that the market was functioning.

* * *

I know that some are calling for multiple integrated regulation of our industry, carving up jurisdiction for futures among several government agencies. Their premise, of course, is that something horrendous happened.

Being a former banker, I look to the bottom line: Some people lost money; some people made money. Some market judgments were right; some were wrong. No defaults occurred. No brokerage firm collapsed. No customer money was lost, other

than through market moves. No banks failed. Established credit lines served their purpose. The markets remained open at all times.

Frankly, our system, in all its intricacy, and with all its protective mechanisms, worked. The Commodity Exchange Act worked. And if there were problems in other areas, responsible governmental agencies could have dealt with them. The Federal Reserve System could have limited commodity loans, if there were a credit and banking problem. The securities firms could have been discouraged from allowing large concentrations of speculative positions through the S.E.C. net capital rule.

We can also all conjure up "what-if" scenarios, but I see little to be gained from such an exercise, since it is abundantly clear that a strong and sound foundation to deal with potential problems has been provided by Congress -- the Commodity Exchange Act. The CFTC, for example, has an arsenal of weapons that far exceeds those conferred on the S.E.C. By any measure, the CFTC has sufficient authority to effectively do its job, and to protect the market. And the system already provides futures customers with important protections not provided securities customers. Segregation, next day settlement, and reparations immediately come to mind.

* * *

This jurisdictional dispute which I referred to is not a new phenomenon, of course. Congress has had to twice go on record -- in 1974, and again in 1978 -- that a single expert agency must have the responsibility for enforcing a coherent regulatory program -- a program that encompasses all elements of futures trading, builds on the strong and sound foundation provided by the Commodity Exchange Act, and which has the economic expertise to focus on the risk-shifting and price discovery functions that futures trading performs.

The regulation of futures trading, after all, is the policing of a function, rather than a particular product. For that reason, assignment of jurisdiction along product lines is simply unwise and would lead to regulatory chaos.

* * *

There is also much talk about taking "margin" authority away from futures market professionals and giving it to a federal agency. In fact, Congressman Glickman has introduced a bill -- H.R. 7183 -- to serve as a foundation for debate on this important issue.

Now it must be understood at the outset that "margins" in futures are not extensions of credit. Rather, our "margins" are good faith deposits intended to assure financial responsibility. This purpose is more closely analogous to a performance bond. In no sense is a commodity "margin" a down-payment.

In determining appropriate levels of futures margins, we must strike a delicate balance. As economists have explained time-and-time again, levels must be high enough for safety, but low enough to avoid (as much as possible) impairing liquidity. They also must not be so high as to increase the costs to hedgers, or to force them into unregulated forward contract arrangements, as Federal Reserve Chairman Volcker has repeatedly warned. I quote:

I would caution against striking out with hastily conceived restrictive legislation... One danger from excessive regulation or the imposition of heavy costs is that activity will shift to unregulated channels here or abroad, potentially leaving the markets more vulnerable than before to manipulation or credit weakness.

This delicate balancing in determining appropriate levels of margin is best done by experienced market professionals who have intimate knowledge of the industry and the flexibility to act promptly. A centralized government agency simply cannot do the job effectively, as Congress has repeatedly concluded after careful review. And as to even so-called "stand-by emergency authority," economists are in agreement that increasing margins is simply not an effective way to curb volatile prices or prevent market manipulation.

It is particularly ironic to hear suggestions for margin controls as a response to what happened in silver. I have heard no one suggest that silver margins were too low. In fact, they were at record levels -- as CFTC Chairman Stone acknowledged last November.

* * *

Turning now to March 1979 wheat, I appeared before you on March 28, 1979 and discussed this matter at some length. I wish to reaffirm that testimony today. We did not have then, nor do we have now, any information which shows that there was an actual or threatened manipulation, corner or squeeze, or that there was a major market disturbance because the longs could not or would not liquidate their positions in an orderly fashion.

A federal judge agreed with this assessment on March 18, 1979, when he enjoined enforcement of the CFTC's so-called "emergency" order. The recent study prepared by Dr. Heifner for this Committee also agrees with this over-all assessment. And the fact is that the contract did liquidate in an orderly fashion, under our close surveillance.

We believed, and still believe, that the CFTC misperceived the situation. We were compelled, therefore, to go to court to protect the integrity of our marketplace. We considered, and still consider, the CFTC's action to have been harmful, since it would have eliminated hedging and price-discovery benefits at a time when the agricultural community needed them the most.

Since I last appeared before you, the U.S. Court of Appeals in Chicago has held that the CFTC "emergency" order in the March wheat case was immune from any judicial review. And the Supreme Court has recently declined to review that decision.

We strongly disagree with the Appeals Court decision, since judicial review is the only means available to assure compliance by the CFTC with Congress' intent and the clear language of Section 8a(9) of the Commodity Exchange Act. Also, without judicial review, markets and market users are denied due process of law. The CFTC can abrogate private contracts, close markets, and fix prices, without those affected ever having a day in court.

Even Congress itself could not do this, since acts of Congress are always reviewable.

For the time being, the decision of the Court of Appeals is the law, at least in Chicago. We trust that other courts, and even the Appeals Court in Chicago, when again confronted with this issue, will conclude that the CFTC is not more powerful than even Congress.

But we hope, also, that the CFTC will continue to exercise the restraint it showed recently in connection with silver, strictly adhering to the standards Congress established for emergency actions.

* * *

While still on the subject of the March 1979 wheat, I do want to comment briefly on the recommendations which have been made by Dr. Heifner in his recent study.

I should note at the outset that Dr. Heifner's paper is a most interesting document. Despite its cautious and dispassionate tone, on closer analysis, it is a clear and strong rebuke to the CFTC for what it did in March 1979. And although the Board of Trade disagrees with Dr. Heifner on some points, overall his study contains a number of valuable insights about futures in general -- particularly his observation that all futures are most properly viewed as "financial instruments," and that delivery is not an indispensable prerequisite to successful futures trading.

The "bottom line" of the study is that the CFTC's action in March 1979 was inappropriate under the circumstances. Nonetheless, being a government report, several recommendations are made.

Dr. Heifner's first recommendation is that the CFTC be given the authority to impose "regularly prescribed limits" on traders' positions during the last few weeks of trading in a maturing futures contract for the express purpose of preventing price manipulation during the delivery. These limits would apply to hedgers as well as speculators.

Our immediate reaction to this recommendation is that, given the extraordinary powers already conferred on the

CFTC, there simply is no need to increase those powers further.

In fact, the CFTC appears to be suggesting something along these lines currently, and has, as Dr. Heifner notes, already published for comment a similar but flawed concept. Clearly the CFTC, at least, believes it needs no further statutory authority in this area.

In the short period of time since the release of Dr. Heifner's study, we have not been able to fully analyze the implications of his principal suggestion -- that stepped-down position limits go into effect during the last 3 weeks of a contract. Obviously, the Board of Trade could voluntarily include such a provision in our futures contract specifications, if it has merit. For this reason, the Board of Trade will be studying this recommendation carefully. Because of its potential impact on market performance, our study will have to include the most rigorous economic analysis.

Dr. Heifner's second recommendation is that the CFTC be given explicit emergency power to impose or reduce maximum allowable positions in a maturing futures contract when one or more traders "gains the ability to control price." There is nothing in current Section 8a(9) of the Act, however, which precludes the CFTC from doing this now, when, in fact, someone has achieved a corner. Thus, no legislation is needed.

In this connection, however, the CFTC should be reminded, as Dr. Heifner states with respect to this recommendation, that "to halt trading would introduce the difficult problem of determining a fair price for settling the remaining open contracts, expose spreaders to unexpected price risk, and erode confidence in the market." This, of course, is what the CFTC attempted to do in March 1979 vis-a-vis Chicago wheat futures.

Dr. Heifner's third recommendation is that the Board of Trade, the CFTC, and interested parties study the Chicago wheat futures contract to make it "less subject to manipulation." First, I disagree with Dr. Heifner's underlying premise, which certainly is not supported by his analysis of March 1979 wheat,

that the Chicago contract is "subject to manipulation." We find no fault, however, in studying our contract to see if improvements can be made. This has been a continuing process at the Board of Trade, of course, over many years.

As for adding even more delivery points, which is suggested as one focus of the study, we note only, as Dr. Heifner concludes earlier in his paper:

But adding delivery points...can only be carried so far before incurring severe disadvantages. Such changes submit the longs to uncertainty about where they will receive delivery....and introduce problems of setting appropriate premiums and discounts for non-par delivery.

A more intriguing suggestion for the focus of a study is "allowing financial settlements based by formula on quoted cash prices in lieu of physical delivery."

This suggestion flows naturally from Dr. Heifner's observation that a futures contract is most properly viewed as a "financial instrument guaranteeing fair value, but not necessarily guaranteeing physical delivery." This analysis has important implications to all futures contracts, but particularly silver and the new family of financial futures being developed.

In any event, we do agree with Dr. Heifner that we must discard certain notions that conceptualize futures as cash market equivalents and view them, instead, as unique financial instruments in their own right.

* * *

The Committee has also asked for our assessment as to whether the CFTC has sufficient authority to carry out effectively its congressional mandate of protecting the users of futures markets and the market mechanism itself. I have already touched briefly on this subject, and it is clear to us that the Commission has sufficient authority. It certainly has broad authority and enforcement powers with respect to contract markets. There may be some weakness in its authority in other areas, however. I have in mind large foreign traders and fraudulent off-exchange activity.

Certainly the CFTC has extraordinary power to prevent manipulation of the futures markets. This authority can be divided into four categories, as detailed in our written submission:

1. The CFTC has authority to bring injunctive and other enforcement action against persons manipulating or attempting to manipulate futures markets. It has the extraordinary power to issue an order directing any person it has reason to believe is manipulating or attempting to manipulate a futures market, or the cash market, or any commodity traded on the futures market, to show cause, within as little as three days, why the person should not be prohibited from trading in the futures markets.

2. The CFTC has the authority to set position limits on the number of futures contracts a person can hold or trade in any commodity.

3. It has the authority to obtain detailed information from traders and brokers about both their cash and futures positions.

4. It has authority to regulate trading by compelling futures exchanges to take CFTC-prescribed actions.

I have already mentioned the CFTC's statutory emergency powers, which the Federal Court of Appeals for the Seventh Circuit has held to be judicially unreviewable, even though both Judge Grady and now Dr. Heifner determined that the actions taken by the CFTC giving rise to the case were ill-advised. Under this precedent, at least, the CFTC is the most powerful agency in government, more powerful than Congress itself.

* * *

The CFTC has adopted stringent capital rules for both exchange members and non-member FCMs. In addition, the requirement that customer funds be kept segregated from other monies, which was adopted by Congress in 1936, is another important protection.

With respect to exchanges, the CFTC must approve all exchange rules relating to terms and conditions of futures contracts or trading requirements, before they are put into effect. Additionally, the CFTC has the power to alter or supplement exchange rules, in certain circumstances.

The CFTC has obvious power when it acts upon applica-

tions for new contract-market designations. An aside: Although the Commission certainly must satisfy itself that the statutory requirements are met before it designates a new contract for futures trading, it appears to us, and others in the industry, that the Commission has been tardy in reviewing and approving new applications.

Once a new contract starts trading, the Commission retains the power to require exchanges to demonstrate that the contract continues to comply with the requirements for designation contained in the Commodity Exchange Act. In addition, the Commission has a scheme of customer protection rules relating to activities of commodity trading advisors, commodity pool operators, FCMs and exchange members. These rules are described in detail in a CFTC study of September, 1979, which is included in our written submission.

* * *

In assessing the CFTC's powers, and its actions in executing these powers, we are struck by the thought that the CFTC's energies are sometimes misdirected. We continue to believe that if there are problems in the futures industry, they generally come -- not from exchanges or members of self-regulatory organizations -- but from other segments of the industry. Congress is well aware, of course, of the problems that were caused by the sales practices of certain options dealers, and the problems that are currently caused by people selling a variety of products which are in reality futures contracts, but are not part of any regulatory entity or exchange. We in the exchange community have no jurisdiction or power to prevent fraud in these areas.

The public often fails, however, to make a distinction between the legitimate and regulated futures industry and the activities of unregulated and sometimes illegal operators. We applaud the recent statements of the CFTC that it is attempting to focus more manpower and attention in this area.

This concludes my summary remarks. We do request that the Committee receive for the record our detailed written statement. We further request that the record be kept open for a reasonable time, in order that we might supplement our statement or reply to any specific legislative proposals that might emerge.

TESTIMONY OF
DR. CLAYTON YEUTTER

PRESIDENT of the CHICAGO MERCANTILE EXCHANGE

Chairman Jones and Members of the Subcommittee:

I am Clayton Yeutter, President of the Chicago Mercantile Exchange and with me at the witness table is Charles Seeger, partner in the law firm of Nelson and Harding, our outside counsel.

We are pleased that your subcommittee, Mr. Chairman, has decided to exercise its oversight authority in light of what recently occurred in the silver market. And we are particularly pleased that your inquiry is broader than those that have been conducted recently by other Congressional subcommittees. In our judgment the relevant issues of the day are industry-wide in scope, and not limited only to the products or institutions which have recently made headlines.

As you know, we do not trade silver on the Chicago Mercantile Exchange. But we do trade gold, another of the precious metals, so we are impacted by what occurs in both the cash and futures markets for silver. For this reason, we followed the silver situation closely during recent months. Our conclusion is that it generated far more public attention than was merited. Statements attributed to some government officials a few weeks ago would have led one to believe that the sky was falling, and that our entire economic system was in danger of collapse. It has become apparent since then that such statements were an exaggeration of what occurred, and that if mistakes were made, they were primarily errors of business judgment rather than of regulatory action or inaction. While silver prices went from \$9 an ounce to \$50 and back to \$10 an ounce in eight months, no calamity occurred. No one defaulted. No exchange clearinghouse or brokerage firm collapsed. No customer money was rendered insecure by what transpired. Perhaps the greatest lesson learned was the fundamental lesson of the discipline of the free marketplace.

That discipline was harsh on the Hunts -- as it always is on those whose judgment about market conditions is in error. But that federal regulators allowed this discipline to work its will is not a cause for alarm, rather it is healthy. The exchanges involved exercised their

self-regulatory role, and the CFTC exercised its oversight role, and both entities did so in a responsible manner. That is the role regulation is supposed to play in a free enterprise economy. Unfortunately, we have too often insisted that it play a larger, more costly, and more disruptive role in recent years.

In short, I concur with Chairman Volcker's testimony before another Congressional Committee, when he stated that no precipitate reform of the futures industry is necessary. The principal reason Chairman Volcker voiced restraint, and made no immediate call for a governmental response, is simply that exchanges display a self-regulatory flexibility that cannot be duplicated by government.

In the silver situation the governing boards of both the Chicago Board of Trade and COMEX met repeatedly, evaluating market conditions on the basis of daily surveillance and monitoring. They used their self-regulatory tools in different fashions and at different times, but ultimately toward the same end. These tools included altering margin requirements, imposing position limits, ordering trading for liquidation only, expanding price trading limits, adjusting spread trading rules, and ordering full time audits to monitor financial integrity. The tools did the job for which they were intended -- maintaining the financial integrity of the marketplace.

This marketplace is of enormous importance to our economy. Today, price volatility and its attendant business risk looms large for both agricultural and non-agricultural businesses and financial institutions. We have reached the point where risk management through the use of futures markets has become imperative for most farmers and livestock producers and many credit institutions and urban businesses. The paramount reason for using futures contracts is to transfer risk. Double digit inflation, double digit interest rates and the uncertainties inherent therein demand attention to risk in the economic decision-making process. A hedger wants to rid himself of some or all of his price risk; a speculator accepts that risk. Both are essential to futures markets, and to the proper functioning of the risk transfer mechanism. Participation in the markets by both hedgers and speculators has grown dramatically in recent years. The Chicago Mercantile Exchange traded four million contracts in 1969, double

that number in 1978, and nearly double that again — twenty million contracts — in 1979. A great deal of that increase was in hedging. But it should be noted that without a concomitant increase in speculation, i.e., risk taking, the growth in hedging could never have occurred. The two go hand in hand.

But my real purpose this morning is not to laud the importance of futures, or defend the self-regulatory capacity of exchanges. Rather, I want to stress to you that at least two issues that have been brought to to your attention are not among the priority concerns of the futures industry. These are the proposals to grant margin and position limit authority to one or more Federal regulatory agencies. I would like to address each of these subjects individually. First, margins.

MARGINS

It would be a major mistake to grant a government agency authority to determine margins on futures contracts. Today such margins are set by the exchanges, whereas margins for securities are established by the Federal Reserve Board, a government agency. This difference has led to a great deal of confusion and recently to ill-informed proposals that if government involvement is appropriate for securities, it should also be appropriate for commodities. The proposals have a reasonable ring to them, but on examination it becomes obvious they have no rational basis. Margins in futures are not the same as margins in securities. They are totally different concepts and the experience in one had no relevance to the other.

The principal objective of margins in futures trading is to protect the integrity of the marketplace. No exchange has ever sacrificed its contract integrity and its responsibilities for customer protection out of a desire to attract traders. This is not a situation in which government must regulate under the theory there is no motivation for the private sector to do so. There is ample motivation for exchanges to raise margins upon even slight provocation. After all, the financial well-being of the institution and its members may be jeopardized if and when a brokerage firm or a customer defaults on a contract. This motivation to raise margins is typically stronger than the motivation to lower them in order to attract more business. That is why commodity exchanges have an enviable

record of customer protection, perhaps the best of any major industry in the country. In more than 100 years of futures trading in the U.S., we have never had a clearinghouse default. Does that kind of record justify the creation of margin authority in a federal regulatory agency? Is it any wonder that the general public is today rebelling against overregulation? Recent proposals for Federal intervention in this area are a classic example of that very proposition -- of government attempting to "fix something that ain't broke."

In the securities industry, margin involves a loan. There is an extension of credit from the broker to the purchaser of a security to fund part of its purchase price. Because there is a loan, interest is charged on the balance due. Ownership of the stock certificate passes immediately. In short, the margin is clearly a down payment in a credit transaction.

In the futures industry, margin is a performance bond. Margin deposits are earnest money. There is no transfer of title of the underlying commodity, and no credit involved in the purchase or sale. Because there is no loan, no interest is charged. Futures contracts merely provide an option to buy or sell the actual product or instrument at some date in the future. At the time of the futures transaction only the price is determined. There is therefore no need for settlement at that time. Nor is it possible to know whether actual payment will ever be necessary.

"Margin" in commodity futures is part of an intricate procedure to guarantee the fiscal integrity of the marketplace. Indeed the clearinghouse system used in futures is dramatically different from that in any other business sector and incredibly safe. Futures typically operate under a "no debt" philosophy. Each open position of every market participant is adjusted daily -- or "marked to the market" -- to reflect profit or loss based on that day's price change. Thus at the start of the following day's market, every participant has either paid or been paid -- in actual cash -- the amount which reflects the previous day's price changes. This intricate "settlement" process is carried out by a "clearing" department or special clearing entity of every exchange, which pays and collects from all the firms who do business on the exchange. Open positions of participants are adjusted to reflect actual fluctuations that take place each day rather than as a sum total over a number of days, weeks or months as in

other financial markets. Thus, no firm owns or is owed any money at the start of trading each day. Obviously such a financial system is much safer for each participant than one which merely keeps track of profits or losses by way of a bookkeeping entry.

The original margin placed by a participant with his firm is simply a security deposit to guarantee contractual performance in the event of adverse price movements over the next several days. Because each participating firm must pay "to the market" each day for every open position it carries, it must have sufficient funds from each of its customers in the event of an adverse market movement. If the open position incurs no loss, the margin is never utilized. On the other hand, if the position erodes the margin below a designated point, additional margin is immediately called for from the customer. If the additional margin is not forthcoming, the firm may liquidate the customer's position.

In inflationary times, when policy-makers want to restrain the use of credit, proposals to regulate margins in futures trading seem inevitably to surface. In 1967, for example, the Vice-Chairman of the Federal Reserve Board was asked to testify on this question. He stated in testimony to the House Banking Committee: "They do not use credit in futures trading . . . (margin) is not credit in the sense that we use the term. It is earnest money."^{1/} This testimony made a key point: Where there is no extension of credit, no restraints are needed.

Margins in equities are set by the Board of Governors of the Federal Reserve System in order to prevent excessive use of credit in the purchase of securities.^{2/} The intent of this authority, when initially granted, was to prevent a recurrence of the stock market collapse of 1929 - a collapse resulting in some measure from the inordinate use of credit to purchase corporate shares.

The extension of credit may be peripheral to the use of futures contracts, but it is by no means central to such activity. Exchanges require that collateral or letters of credit from approved banks be held in customer accounts to assure customer performance. Hence, any credit extended to provide margin funds is based either on collateral held by a clearing member or collateral in the form of a bank commitment. The bank, in turn, makes such commitments based on the customer's financial statements, not on the customer's position in the futures market.

It is not by accident that U.S. futures exchanges have such a superlative record of contract performance and customer protection. Margins have done their job, and they have done so because of: (1) the administrative and regulatory flexibility of exchanges; (2) their ability to interrogate clearing members in a timely and effective manner concerning their own positions and the position of their customers; and (3) their ability to function in the strictest confidence. In order to set margins effectively, a federal agency would need to duplicate these criteria. It is not only unlikely but inconceivable that this would occur.

Examples of the importance of flexibility and quick response in setting margins are legion. Sometimes margins are changed daily in response to events of the trading day. They always must be adjusted by morning. Think for a moment what a federal bureaucracy would be required to do to provide that kind of continuous, instantaneous monitoring capability for all margins on all futures contracts on all U.S. exchanges.

Those who advocate granting margin authority to a Federal agency apparently believe that margins have in the past been too low. Otherwise there would be no rationale whatsoever for their proposals. What they forget — or perhaps ignore — however, is that higher margins are not necessarily in the public interest.

Setting margins at a level higher than necessary increases marketing costs. This makes hedging, the transfer of risk, more costly. The result is "economic waste" which will unquestionably be passed on to customers. Higher margins will also tend to drive hedgers from the futures market into unregulated forward markets. From a public policy standpoint, this would hardly seem to be desirable.

Increased margin costs will also drive participants from domestic futures markets into foreign markets, and likewise dissuade foreign buyers and sellers from using U.S. futures exchanges. Reduced trading volumes resulting therefrom will make our markets less effective and less competitive, thereby adversely affecting both their price discovery and risk transfer functions. Obviously, this would be a regressive step.

Additionally, the CFTC presently has the authority to "take such action as, in the Commission's judgment, is necessary to maintain or restore orderly trading in, and liquidation of, any futures contract" when

the Commission believes an emergency, such as market manipulation, exists.^{3/} This emergency power has been used by the CFTC to direct an exchange to impose higher margin requirements.^{4/} Hence, the CFTC is not powerless to act if and when a situation develops that is so troublesome as to be denominated an emergency.

Finally, margins set by the Federal Reserve Board for the securities industry are relatively inflexible. They were last set at 50%, and this requirement has remained unadjusted since 1974. For programs where rules need be changed only infrequently, government regulation is feasible.

Margins on commodity futures contracts, however, are an entirely different matter. Performance bond requirements, by their very nature, are not stable and predictable. They depend primarily on the expected volatility of prices. Thus margins vary substantially from contract to contract, and from day to day. For the entire futures industry, the number of margin determinations — which must be monitored on a continual basis and altered frequently — is in the hundreds. We use minimum margins, maintenance margins, spread margins, delivery month margins and speculative and hedging margins. This is not an environment in which a government agency traditionally fares well. It is a decision making function far better left to the private sector, in this case, the exchanges.

In summary, appropriate public policy for the extension of credit in the securities industry has no relevance to margin regulation in the commodity futures trading industry. Unfortunately, the inadequacies of the English language have led to a great deal of confusion over margins. The same word applies in both industries, but the function is entirely different. The futures industry is not without its challenges; they are inevitable in a rapidly growing, dynamic industry. But margins are not one of those challenges. The alleged need for federal intervention in this area can best be described as a solution looking for a problem.

SPECULATIVE POSITION LIMITS

Speculative position limits — limits on the number of open contracts any one speculator can hold or control are a sound regulatory tool under appropriate circumstances. We use it now. The COME has a number of contracts with exchange imposed speculative position limits, and standby

authority in all others.^{5/} The CFTC has the power now to impose such limits and they have done so in ten commodities. In short, the existing self-regulatory and agency oversight relationship works.

It works for a most obvious reason -- self-interest. No exchange wants to allow price distortions on its markets. Price distortion directly threatens the major economic benefits which our markets provide -- accurate price discovery and the efficient shifting of risk. None of these economic processes can occur effectively if prices are artificially moved away from their real supply/demand equilibrium.

Monitoring that equilibrium is not easy. It is often difficult to determine when a market is distorted. There is always a degree of uncertainty about the equilibrium price because of unknowns about supply and demand. That is, of course, why futures markets developed in the first place. In practice, the evaluation of price distortion is a constant one, monitored daily, and always resolved on a case-by-case basis. The issue of speculative position limits is continually under consideration at our exchange for every contract.

The Committee will find it interesting to note what Dr. Gary SeEVERS, former Vice-Chairman of the CFTC, and his Advisory Committee concluded on this issue:

"Speculative position limits should not play a major role in the CFTC's future regulatory program. In the long run, they should be supplanted by an improved monitoring and surveillance program designed to achieve orderly liquidation of expiring contract months."^{6/}

I fully concur with that assessment. One must not assume, as some government officials have recently, that large scale speculative activity is detrimental per se. Such activity is undesirable only when it may have a distortive effect on price. This depends on the characteristics of the market, the relative size of traders and their positions at a given point in time, and on the amount of free supplies that could be delivered under futures contracts.

The obvious objective of speculative limits is to reduce market influence by limiting access. However, if the limitation on market access is too great, there will be a real efficiency cost because of reduced liquidity. Natural forces of the market tend to limit the size of speculative positions and trades in any event, and limits that are too low

pose a far greater danger than limits that are too high.

Speculation is a vital, beneficial force in futures markets. Speculators bridge the time gap between short and long hedgers. They accept the risks which hedgers seek to avoid. They provide the independent judgments which give producers and consumers a price estimate that reflects anticipated supply and demand. Far from being discouraged, speculation should be encouraged to continue that positive role in the marketplace. The more participation the greater the accuracy of the weighted opinion of what price a commodity will be in the future, given today's information. Through this process futures markets provide reference points for the consummation of future business transactions at competitively determined prices. The widespread dissemination of futures prices also fosters competition in the establishment of current cash prices in many local markets. And futures prices help to establish market values in a wide range of productive services such as storage, transportation, and processing and, in recent years, even in the cost of money. Interestingly, despite an uninformed consensus to the contrary, there is no evidence to indicate that speculators represent a greater market menace than hedgers to the effective performance of the markets.^{7/}

Despite our strong feeling that exchanges are in the best position to impose speculative position limits -- which is reinforced by our history of a willingness to do so -- once again the CFTC is resurrecting this issue. Just last week the Commissioners again directed staff to review the issue of the imposition of speculative position limits. We will continue to vigorously assert the need for, and unique ability of, exchanges to deal with this sensitive, intricate question.

CONCLUSION

Finally, a few general comments on regulation of our industry. As futures trading has increased in importance in this country, and as trading volumes have climbed, the profile of the industry has inevitably risen. We were relatively unnoticed as recently as two decades ago. And, in fact, much of the growth of this industry has occurred during the past ten years. Risk management in most financial instruments is only five years of age. We are truly in the embryonic stages of the metamorphosis of this industry, and that has major public policy implications.

First, businessmen are still learning how to use futures contracts to transfer risk. Those who are not yet users are fearful of the unknown. Some are wont to strike out at this mechanism for its alleged effect on cash markets. There are even some government officials in this category! Raising the level of economic understanding of the function of futures trading, and its complementarity to the cash market, is, therefore, a major challenge for all of us.

Those businessmen and financial institutions just beginning to use the futures market will inevitably make errors. Some will put on a short hedge just as the market begins to rise. Others will put on a long hedge just as the market begins to fall. In both cases, they will have to fret over margin calls, and they will experience an "opportunity cost" in lost profits. Others will cross the line from hedging to speculation, and suffer severe financial losses. Still others, those who are deliberate risk takers, i.e., speculators, will erroneously evaluate market conditions and lose some or all of their speculative capital in the process. In all these cases, there will be a tendency to blame someone -- in particular, someone other than themselves -- for the losses. There will be charges of excessive speculation or price manipulation by their fellow market participants, inadequate disclosure of risk by the brokerage community, ineffective self-regulation by exchanges, and inordinately passive regulation by the CFTC. This will create pressure for additional regulation, whether or not the charges are valid, and those pressures will reach a crescendo when a Hunt case comes along every decade or so.

The point I wish to leave with the Subcommittee is that we ought to keep all of this in perspective, and neither the exchanges, the CFTC, nor the Congress ought to overreact to a given situation. Additional legislation is not needed today, and is not likely to be essential in the foreseeable future. The Commodity Futures Trading Act is soundly conceived, and has served this nation well since its inception. There are inadequacies to be sure. Neither the exchanges nor the CFTC are perfect, but a utopian regulatory environment is not likely ever to exist. A regulated industry should be judged primarily by its customer protection, and in this respect the futures industry has a superb record. If there be blemishes, and they are relatively few for a multi-trillion dollar indus-

try, those blemishes are due to shortcomings in regulatory execution rather than in regulatory authority.

I do not believe that the silver situation, or anything else that has occurred in futures trading in recent months, justifies or supports the regulatory proposals that have recently surfaced. In our opinion, every proposal introduced in the Congress to date would not only be damaging to the industry, but damaging to the general public as well. Mr. Chairman, you and your Subcommittee understand this very well. We just hope that some of your Congressional colleagues will refrain from attempting to cure all the alleged ills of the economic world through additional Federal legislation and regulation. If the CFTC does its job properly, and if we in the industry who have regulatory responsibilities do our jobs properly, this whole debate will be superfluous.

Mr. Chairman, I would be pleased to answer any questions that you might have.

^{1/} Testimony, Vice Chairman of the Federal Reserve Board, James L. Robertson, accompanied by Charles Partee, to the Committee on Banking and Currency, House of Representatives, Hearings on Consumer Credit Protection Act, H.R. 11601, Part 1, p. 135, August, 1967.

^{2/} Section 7(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78g(a)).

^{3/} Section 8(a)(9) of the Commodity Exchange Act, as amended.

^{4/} In re November, 1976 Maine Potatoes Futures Contract Traded on the New York Mercantile Exchange: Orders Pursuant to Section 8(a)(9) of the Commodity Exchange Act, as amended, Commodity Futures Law Repr., Para. 23,333 (CFTC Order Issued November 3, 1976), see also, Commodity Futures Law Report, Para. 20,237.

^{5/} Express standby authority in all except currencies and silver coins; emergency standby authority in all contracts.

^{6/} Report of the Commodity Futures Trading Commission Advisory Committee on the Economic Role of Contract Markets, Gary L. SeEVERS, Chairman, July 1976, p. 4.

^{7/} In fact, five of the eight market manipulation cases brought under the Commodity Exchange Act between 1972 and 1975 were against commercial operators with hedging exemptions for at least the major part of their trading.

STATEMENT

OF

THE BOARD OF TRADE OF KANSAS CITY, MISSOURI, INC.

Presented by H. R. Schmid, President, and W. N. Vernon, Executive Vice President

I. INTRODUCTION

We appreciate the opportunity to share our exchange's views on this important subject with you. At the conclusion of our remarks, we will be pleased to try to answer any questions you may have. Our representatives are identified at the end.

A. The Board of Trade of Kansas City, Missouri, Inc., (sometimes called the "Kansas City Board of Trade" and herein called KCBOT) is a cash or spot grain market for all types of grains (including soybeans) and is a designated futures contract market for several grain futures, the current active contract being hard red winter wheat. With a history of 125 years, and more than 100 years of grain futures trading, this is clearly one of the "old line" grain exchanges. Today the market retains much of the flavor of a commercial, or hedgers' market, even though the number and volume of both total trade, and floor trade (and floor traders) have increased significantly in the last few years. As a point of reference, 1979 wheat futures traded exceeded five billion bushels, and 1979 receipts of cash grains were 215,000,000 bushels with shipments of 123,000,000 bushels (rounded).

The KCBOT includes among its members millers, processors, exporters, elevator operators (country, subterminal, and terminal), cash and futures brokers, grain merchandisers, wire houses, FCM's (futures commission merchants), a large wholesale baker, and others. The size of firms ranges from sole proprietorships to some of the largest enterprises in the United States, including several very large marketing cooperatives owned by local elevators, and therefore indirectly by producers.

B. As a representative of the vast, productive Midwest grain growing and merchandising area and firms, we strongly support continuation of the well-functioning present status of regulation of so-called commodity margins, namely, solely by the exchanges themselves, or the CFTC only in an emergency. ^{1/}

We would not object to additional laws or regulations directed solely to funds which may (or may not) be loaned by federally regulated financial institutions for the purpose of financing speculation in commodity futures contracts. This would be consistent with Federal Reserve Board stock purchase credit margin setting authority in the Securities law. Nor would we object to language giving explicit authority to the CFTC to set margins in an emergency, provided some right of appeal was granted.

However, we find it necessary to oppose the bill in its present form as we feel it gives far too much day-to-day power to an agency staffed for the most part with non-commodity trained persons. The several lists of factors which separately may be considered as giving a clear road to control of the commodity markets, if for no other purpose than to appease whichever political pressure group is the strongest in objecting to prices. Generally consumers want low prices; producers, high prices. The balancing should be done by market forces representing millions of decision makers, not by administrative decree of a few bureaucrats. We suspect the far-reaching import of this bill was not intended by its supporters. However, if the bill were to be slightly amended ^{2/} to insure that a review of all relevant factors together was undertaken, we would have much less concern. Even so amended, we would still oppose the measure on principle as unnecessary and an opening for unwarranted interference in the market. For the same general reasons, we would oppose giving to the CFTC, or any federal body, margin setting authority over any commodity futures contract on the general principle that all commodities should be regulated the same; and what is "done to" one commodity futures contract today can be "done to" others in the future.

Likewise, while we do not understand that the issue of CFTC exclusive regulatory jurisdiction over all commodity futures contracts, including our pending stock index futures contract, is before the Congress at this time, we do speak up in strong support of CFTC exclusive jurisdiction over all commodity futures contracts.

The only needed legislative change we see is to provide for some judicial review of CFTC emergency orders, even if it be to

the Circuit Courts based on the "arbitrary, capricious, and unreasonable" standard.

II. "COMMODITY MARGIN" - DEFINITION, RULE

A. A so-called "commodity margin" is a mislabeled financial device. In fact, the so-called commodity futures contract "margin" is no more than an earnest money deposit to guarantee performance, much as the deposit home buyers put up when they enter into a contract of sale. (See authorities listed in Appendix).

A commodity margin is not a loan to finance the purchase of a commodity, as is the case of regulated security margins by the Federal Reserve Board. In commodity trading, the participants are trading intangible promises or executory contracts - "choses in action," to use a legal concept. No credit is involved. There is no actual commodity being purchased, as with securities, where evidence of title is held as security for repayment by a lender.

Moreover, commodity "margin" funds are very secure, under long-standing CFTC segregation requirements. Customer funds deposited with FCM's and subsequently paid over to commodity exchange clearing organizations are:

- 1) held in segregated bank accounts, where the bank has agreed to hold the funds separate and apart from the funds of the firm, for the account of the customer;
- 2) invested only in certain high quality, liquid U.S. securities.

This last year (1979) saw a further development in the protection of such funds, in the form of amendments to the Federal Bankruptcy Act to close any possible loophole that might have permitted general creditors, through a Trustee in Bankruptcy, to assert a pro rata claim on such customer funds.

Segregation protection, plus exchange and CFTC financial audits of FCM's, the CFTC's reporting and financial requirements for FCM's now enforced also by exchanges, the fact that positions are brought to market daily or closed out, and the fact that FCM's are responsible to clearing houses instantly for margin funds in the first instance, combined, make for a safe, smooth functioning system. Historically there have been no major scandals or disasters due to improper margins; thus there is no demonstrated need for more gov-

ernmental regulation. In fact, it can be persuasively argued that commodity "margins" are safer than security margins for the market participant, as will be illustrated. A person buying stock on 50% margin completes his transaction; and for the moment he has no reason to maintain contact with the stockbroker/dealer. The customer may then take a vacation, or go about his normal activities. The stock can drop 25% in value (or 50% of the customer's investment) before the broker must call him for more margin, under New York Stock Exchange rules.

By contrast, a commodity dealer (FCM) would stay in close contact with his customer, because if the market goes against the customer's position, the FCM will demand more margin, to protect his position at the clearing house. If no margin is forthcoming, by intention (to get out of a losing position) or by accident (i.e., the customer can't be found), the position will be liquidated, stopping the loss. The point is, the call that the market has gone against you is a decision-point - a forced time for reappraisal, at which point the customer must consciously decide whether to cut his loss and sell, or stay in but put up more margin funds.

III. PURPOSE OF "MARGINS"

In general it may be said that the purpose of commodity "margins," other than to guarantee performance, is to protect the financial solvency of FCM's and the clearing houses - that is, to protect the financial integrity of the total market. Their purpose is not to regulate prices, nor to regulate speculative activity per se. Generally commodity "margins" are raised in response to higher variability of commodity futures prices (sometimes called "wild gyrations" in the press) in order to maintain solvency of all in the markets. When a market "settles back down," the margin levels are reduced. While extremely high margins will impact on the volume of futures trade - that is a side effect. ^{3/}

In most situations requiring regulatory market control, there are many other tools available which are better than extremely high margins, such as position limits, liquidation orders (in total, or to a given level or percent), trading for liquidation only, etc.

There is a view that commodity speculation fuels inflation.

We believe the converse is true - inflation compels drastic action to protect the real value of assets and personal holdings. In times of high price volatility, hedgers need the futures markets even more, which in turn means there is an increased need for speculators as persons scramble to maintain the total economic value of their estate. Margins which are unnecessarily high sterilize capital, and discourage hedging, both due to the cost and due to a reduction in speculative trades. In a broad sense, so-called speculation without ownership of an actual commodity position for the futures trades may be seen as a hedge against inflation.

Another important point is that active, liquid futures markets tend to be less volatile, over time, than thin markets, where the impact of a single large trade is much greater. And again, overly large margins will discourage trading.

IV. EXPANSIVE CFTC ROLE

A. We do not believe the proponents of the bill fully appreciate the problems exchanges are now having with the CFTC. Not only does it often take several years to get rules approved (often rules the CFTC required), but a recent policy position has been adopted that the CFTC will take an expansive view of rule approval authority, and more stringent new contract standards are likely. ^{4/} Currently not only the law and regulations, but form and draftsmanship are considered by the CFTC in rule consideration. With the new expansive view that public purpose is to be considered, years may stretch into decades.

The main points are that --

- a) The CFTC sees an expanding, expansive role for itself.
- b) Margin authority under the bill is a much greater role than they now have.
- c) The CFTC lacks the necessary experts to deal with the issues.

To expand the last issue - there are now some 40 to 50 relatively active contracts, 20 to 30 fairly inactive contracts, and 20 new contracts pending CFTC approval (including those of two new exchanges). Even if no new contracts are ever approved, which is unlikely, the current range of products and industries involved precludes the CFTC or any agency from gathering expertise to equal that

of exchange staffs, officials, and members. Thus we fear the bill will encourage inexperienced CFTC staffers to use this authority to regulate prices, since their current thinking is to broaden, not narrow, their regulatory horizons.

B. Notwithstanding sometimes contrary views, we believe on a day-by-day basis, commodity exchange boards elected by their peers, committees, and staffs provide a pool of experienced experts in the respective commodities. By way of illustration, refer back to our introduction to see the wide range of economic interests represented at the KCBOT. Aside from the fact that they are all competitors - buyer v. seller; exporter v. importer, etc., they are both buyer and seller (or seller and buyer) for any one commodity. If they are spreaders - Jul/Sep, or say, KC/Mpls, or KC/Chgo, or Mpls/Chgo, for wheat, the overall net position may not be the same as the one held in a single month or even at one market. Also, brokers are basically order-fillers - neutral on prices.

C. Because of pressures real and imagined, the CFTC is overly cautious in delivery months. (By "cautious," we mean they are very fearful of any sign of a corner, squeeze, or manipulation, and thus see any slight variation from 'norm' in any of the factors a) through d) listed in the bill as the signal of impending market disruption). Since the press and some in Congress appear more willing (even eager) to criticize lack of action (silver) than taking action (CBOT March 1979 wheat), this puts a premium on doing something, even if it's wrong. To say this another way, we believe the CFTC is already too afraid of markets, is too quick to see problems when often none exist, and does not need any further encouragement to respond to market situations by ordering higher margins only on the basis of one of the factors listed. For example, as a commercial market we often have heavy deliveries (say, 6 million bushels of wheat) between commercial firms, with hardly a ripple in the market. Such positions may comprise 50 to 90% of the open interest just before delivery.^{5/} Yet there is no corner, squeeze or manipulation. Our staff, committees, Officers and Board are well familiar with local market characteristics - yet they could well trouble 'ex-

perts" with only a textbook mentality and trigger some margin policy response, which would not only be unnecessary, but which could be harmful to the marketing system. Another example - high or low prices quickly established are no sign in the abstract of a market problem - markets exist to find values; and this role is most vital in unusual situations. But to listen to some, high prices alone dictate higher margins. Moreover, margins are a very poor tool against manipulation. They penalize all of one side (longs or shorts) for the acts (real or imagined) of a few, and reward the other side unnecessarily. Increased market participation and volume (the remedy for manipulation) would be more difficult.

D. Also there is no pressure on any governmental agency to reduce margins after the situation that caused them to be raised has abated. By contrast, traders representing firms who use the markets want to lower them just as soon as it is safe to do so.

E. We often note with pride that the grain marketing system, including hedging with futures, permits the grain firms, who together handle massive volumes of grain, feeding the hungry here and abroad, to operate on a small profit margin per unit handled. This permits them to pay more to producers and charge less to consumers. The cost of hedging is on balance nominal. But if the government were to unnecessarily raise margins on wheat, let us say, the result would be a need for more capital on deposit \$/ by grain firms. This would increase the cost of marketing, and ultimately be passed on by a charge to the consumer and a reduction in price paid to producers. In a word, it would have both inflationary and income distribution effects.

V. NORMATIVE ISSUE (AN ECONOMIC ANALYSIS)

At what levels should futures margins be set? Aside from adequacy to assure performance, are there other aspects to be taken into consideration?

Robert M. Bear ("Margin Levels and the Behavior of Futures Prices," Journal of Financial and Quantitative Analysis, Sept. 1972, pp. 1907-1930) demonstrates that different margin levels are associated with market price behavior. "The non-random behavior is con-

sistent with the hypothesis that, in certain periods, margin levels have been set too high to attract a volume of speculative services necessary for the maintenance of market balance" (p. 1907). "Since margins are a basic component in determination of expected return, the relationship of margin levels to expected price changes and expected price volatility is directly linked with the demand for and supply of speculative services" (to balance needs of hedgers) (p. 1911). "Using the notion that a futures market is in balance when price behavior patterns are random ... if margins are set too high, a deficiency of speculative services will impede the rapid adjustment of price to new information. Thus, a positive dependency in day-to-day price changes will be evident. Conversely, excessive speculative interest, to the extent it promotes overadjustment of price to the true economic value of new information, would provoke excessive variability characterized by a tendency toward reversal" (pp. 1911-12).

"Futures markets are recognized as proper markets for testing random-walk models, and a case can be made that they are superior to securities markets on informational and liquidity features with respect to the neo-classical conditions of efficient markets" (p. 1909).

Bear tested a random-walk model in terms of serial correlation coefficients and run analysis (i.e., signs of successive daily price changes) with regard to grouping arrangements of margin levels for May wheat and May soybean futures (1948-1969) (p. 1921). Although he found the process generating daily price changes "is nonstationary," further tests provide evidence of systematic changes in the form of the distribution of daily price changes as margin levels change (p. 1921).

He concluded that "a change in margin levels directly influences price behavior by its structural impact on the market" (p. 1925) ... "Variation in observed distribution properties formed a pattern consistent with the hypothesis that margin levels are in certain periods established at too high a level to attract speculative interest sufficient to randomize price behavior" (p. 1928).

Rapid adjustments by expert, experienced commodity traders are critical to well-functioning, responsive markets. We conclude there is a far greater economic risk from margins too high than from margins which are too low.

VI. BANKER'S VIEW

In 1966 Dr. Roger W. Gray testified before a House Subcommittee, at the request of several major banks ^{1/} who were actively engaged in financing hedgers' purchases of grain. Much of his paper was directed to general comments in support of hedging, and to specific provisions of the bill then under discussion, H.R. 11788. Most of his remarks are still true today. In addition to the points already made in this paper, Dr. Gray called attention to three kinds of commodity "margins" --

- 1) Profit margin per unit of product handled.
- 2) Credit margins of banks which finance purchase and sale of cash commodities.
- 3) Commodity futures margins.

"Any 'fat' that exists in any of these three margins represents sheer economic waste and inefficiency." He went on to point out the heavy use of bank credit made by grain firms, and the favorable terms extended, both in terms of interest and the high value of grain for collateral purposes. This latter is due to several factors - a ready and liquid market, the fact that it is hedged, and the excellent storage facilities and grain handling techniques.

"The emphasis ... throughout the system is on the lowest possible margins consistent with safety. Low margins mean low costs - higher credit margins or higher futures margins necessarily mean higher costs, reflected in higher gross margins of processors and merchants. The sole purpose of either credit margins or futures margins is to provide safety."

Other points he made included:

- 1) Low margins encourage easy market entry, providing competitive, active, liquid markets, providing insurance against monopoly power.
- 2) Raising margins in the face of a manipulation would eliminate the one thing a manipulator does not want - ready traders to take his position.

- 3) Margin control by government would bring a danger of disruption of well-functioning markets by persons not attuned to the system.
- 4) Danger of margins so high that use of futures could become prohibitive. A merchant invests capital in a commodity, and will hedge at a low cost - say 5%. But at 25% or 50% of value, his capital needs have increased to the point where the cost exceeds the protection, and though risky, it becomes more economic not to hedge.
- 5) High margins deter speculation, which is needed to make the markets efficient.
- 6) Higher margins would force smaller traders out of the market, increasing concentration.
- 7) High margins in some commodities would send traders abroad.

Lastly, on the subject of the difference between stock and commodity margins, Dr. Gray observed that commodity futures transactions are symmetrical with respect to buying and selling (since both buyer and seller put up the same margin) whereas in stocks this is not so. Increased capital into commodities futures flows to both sides, and thus is neutral on inflation, whereas capital for stock purchases tends to push up prices. Secondly, the futures prices must relate to and as they expire, move toward, the cash price of the actual commodities. Thus commodity futures per se are fairly neutral on inflation, apart from their relationship with the cash price.

VII. NEED FOR FUTURES MARKETS (AN ILLUSTRATION)

We know it is not necessary to again make a lengthy explanation of the many benefits and uses of futures markets to this knowledgeable committee. But a recent event so graphically illustrated this point that we wish to call it to your attention, in the context of what would happen if some agency were to increase margins to the point where futures trading were to cease.

The days are January 7 and 8, 1980, and to some extent, the rest of that week. Point - when the grain futures markets were ordered not to open by the CFTC, after the President's substantial reduction of Soviet sales, all cash grain business ceased, and all bids to purchase grain were withdrawn. The two basic reasons were:

- 1) Without futures markets, the value of grain is unknown.
- This illustrates the price discovery and dissemination function.

- 2) Without futures, potential buyers could not hedge, or protect their position.
 - This illustrates the hedging function.

Moreover, in those rare cases where a producer insisted on making a sale (perhaps he needed cash to make a loan payment or pay a pressing bill), the merchant "took protection" (lowered the price) because he had no other way to protect himself, fearing further price reduction. Naturally when trading began, and the prices recovered somewhat, that merchant made a higher profit than he would if he had been hedged.

This illustrates that futures markets help producers receive more for their commodities than would otherwise be the case.

VIII. CONCLUSION

While it may be true that Franklin D. Roosevelt and Harry S. Truman urged commodity margin control, of much greater significance is the fact that Congress, wisely in our judgment, has refused on repeated occasions over 40 or 50 years to give any government agency authority over commodity margins.

The emotional, political, and power-seeking calls for commodity margin control to hold down (or up - which is it?) prices are almost always predictable in timing, and in lack of data and analysis (other than price movement) to show a cause-effect relationship. By contrast, the lengthy, careful, complex, objective, and often "dry" studies necessary to prove (or disprove, as is usually the case) the case for more regulation are often lacking, or if in existence, initially ignored.

Perhaps an update of the 1966 study done for USDA-Economic Research Bureau would provide some substantiation to the proponents or to the opponents of this bill, and could be completed in time to be considered as part of the 1981 review of the CFTC's reauthorization.

We have attached a list of prior published presentations opposing commodity margin regulatory authority in the federal government, and some textbook discussions of margins, if a more theoretical analysis would be helpful, which we would call to your attention.

We wish to conclude by quoting from part of the paper prepared by Dr. Roger W. Gray of Stanford University, and presented to a similar hearing in 1966:

"Considered against the background of even this minimal understanding of the system, the provisions of H.R. 11788 pertaining to margins must be unalterably opposed as reflecting lack of understanding, as ascribing to margin requirements a novel and alien purpose which they were never intended to serve; and as posing the threat of raising marketing costs and disrupting the marketing system, without offering any real prospect of accomplishing the purposes there ascribed to them." (p. 64, Report of Hearings before the Subcommittee on Domestic Marketing and Consumer Relations of the Committee on Agriculture, Eighty-Ninth Congress, Second Session on H.R. 11788, April 4, 5, and 6, 1966 - Serial CC).

This concludes our comments. Thank you.

- 1/ This authority is not explicit in the Commodity Exchange Act, but is the position taken by the CFTC and exercised at least once, based on an interpretation of the law.
- 2/ by inserting "the combination of" before (A), and changing "or" before (E) to "and"..., to insure all relevant factors are considered.
- 3/ Higher than normal margins may be imposed across the board, or only on one firm in financial difficulty.
- 4/ We believe these will go against Congress' desire to encourage new, innovative futures contracts.
- 5/ Of course, the mere fact of a high percent of the market's open position shortly before expiration alone is meaningless, since 1) the longer a position is held, the higher its percentage will be in relationship to the total reducing position; and 2) the last position will comprise 100% of the open interest.
- 6/ At least at Kansas City where cash is required for margins.
- 7/ First Nat'l Bank of Kansas City; Commerce Trust Company, Kansas City; Continental Ill. Nat'l Bank & Trust Co., Chicago; Northwestern Nat'l Bank of Minneapolis; First Nat'l Bank of Minn.; and The First Nat'l Bank of Chicago. We know they are still financing grain purchases, and assume, therefore, their views are generally the same today.

Mr. H. R. "John" Schmid is the elected 1980 member President of the Kansas City Board of Trade. Professionally he is Vice-Chairman of Garnac Grain Co., Inc.

Mr. W. N. "Walt" Vernon III since March 1, 1973, has been the appointed non-member Chief Executive Officer of the Kansas City Board of Trade. His previous training and experience were as an attorney in the wholesale baking industry.

This paper was prepared under the guidance and direction of the Legislative Committee of the Kansas City Board of Trade:

J. B. Gregg, Chmn.	Morrison-Gregg-Mitchell Grain Co.	Partner
F. R. Daly	Cargill, Incorporated	Southwestern Regional Mgr.
E. J. Egan	The Pillsbury Company	Grain Merchandiser
D. W. Gibson	Wolcott & Lincoln, Inc.	Futures Trader
J. A. Layton	Farmers Export Co.	President
D. H. Shay	Shay Grain Co.	President
W. C. Theis	Simonds-Shields-Theis Grain Co.	Chairman

APPENDIX A

1

COMMODITY MARGINS - HOW DO THEY WORK
WHEAT - KCBOT

Customer Margin Minimum - The KCBOT Directors set a minimum customer margin. Currently:

	<u>per 5,000-bu. contract</u>
20¢ bu. speculative - initial	\$1,000
15¢ bu. speculative - maintenance	750
15¢ bu. initial - hedging	750
5¢ bu. KC-Chgo spread/KC side if on books of a joint member firm (also applies to a KC-Mpls spread or Chgo-Mpls spread)	250
2¢ bu. KC inter-market spread	100

Generally PCM's require more than the minimum margin. The funds are held in segregated accounts, and if paid in cash, invested in T-Bills.

Clearing Margins

	<u>per 5,000-bu. contract</u>
15¢ bu. net open position	\$750
2¢ bu. spread - inter-market	100
5¢ bu. KC-Chgo, KC-Mpls	250
In application, an PCM/clearing member with 10,000 bus. (two contracts) long and 15,000 bus. short, would put up -	
10,000 spread	10,000
long	short
5,000 net short	750

At the end of each day, based on the settlement price, each margin account will be credited or debited to the extent of the market moves that day. A credit may be withdrawn from the Clearing Company, a debit must be paid in. Funds are transferred by wire-transfer through the banking system, on calls from the firms and clearing house.

At Kansas City, if the market moves up 10¢ or down 10¢ (or more) during the day, a margin call goes out, which must be met within one hour. Note that commercial firms may be clearing members for their own accounts, such firms are not PCM's and use the hedging margins. Most PCM's will close out a position if a customer does not supply additional margin funds as required, because they do not want to put up their own capital for their customers.

At Kansas City, the margin funds to the Clearing Company (a 100% owned subsidiary corporation) must be put up in cash. They are invested in T-Bills, with 30% of the interest paid back to the clearing members, and 70% used to pay KCBOT expenses and fund the safety reserves. PCM customers put up cash or T-Bills as they work out.

APPENDIX B

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For additional comments on commodity margin regulation, see the following:

Hearings before the Subcommittee on Domestic Marketing and Consumer Relations of the Committee on Agriculture, House of Representatives, Eighty-Ninth Congress, Second Session, on H.R. 11788, to Amend the Commodity Exchange Act. April 4, 5 and 6, 1966 (Serial CC) - Printed Report

Proposed Sec. 4, of H.R. 11788, pp.3,4

Leonor K. Sullivan - M.O.C. (Mo.), p. 10 - PRO
 George L. Mehren, Asst. Sec., USDA, pp. 11, 12, 21, 26 - PRO
 but limited to "extreme circumstances" p. 21
 Alex Caldwell, Administrator, CEA, pp. 21, 28, 29, 30 - PRO
 Philip A. Loomis, Gen. Counsel, SEC, p. 33- NEUTRAL
 Everett B. Harris, Pres., Chicago Merc. Exch., pp. 39,40 - CON
 Roy V. Edwards, Wilson & Co., p. 41 - CON
 Robert L. Martin, Chmn., Chicago Board of Trade, pp.49,50 - CON
 Dr. Roger Gray, Professor, Stanford University, pp. 61-68 - CON
 Marion Rhodes, Pres., N.Y. Cotton Exchange, pp. 72,74,75 - CON
 Roy F. Hendrickson, Exec.Secy., Nat'l Federation of Grain Cooperatives, p. 82 - CON
 George Bicknell, Asst. Gen. Mgr., Farmers Union Coop., p.86 - CON
 William G. Carton, EVP, Ill. Coop., p. 87 - CON
 L. W. Andreas, Natl. Soybean Processors Ass'n, p. 89 - CON
 W. C. Theis, VP, KCBOT, pp. 91, 94-96 - CON
 (See table of margin changes, 1934-1963, pp. 98,99)
 James J. Cairns, Pres., Wool Associates, p. 103 - CON
 Robert B. Parrott, Natl. Grain & Feed Ass'n, pp.115,123 - CON
 Robert L. Searles, Chmn., Natl. Grain Trade Council, p. 127 - CON
 Ralph Bagley, Minneapolis Grain Exchange, pp. 130-131,135,136-CON
 James Hogan, Ralston Purina, Am.Feed Mfg.Ass'n, p. 140 - CON
 Charles W. Pence, Asst. to Pres., Great Plains Wheat, pp 142-3-CON
 T.A.Hieronymus, Prof. Ag.Econ., U. of Ill., p.152 - CON
 John C. Lynn, Leg.Dir., Am.Farm Bureau, p. 154 - CON
 Harry L. Graham, Leg. Reg., Nat. Grange - PRO
 D. W. Brooks, VP, Nat. Cotton Council, p. 163 - CON
 Angus McDonald, Dir. Research, Nat. Farmers Union, p. 165, generally - PRO
 Don Brouillette, Country Elevator Operator, Ind., p.171 - CON
 Alvin Fischbach, Pres., Lochiel El. Co., Fowler, Ind., pp.172-3-CON
 Hon. Mark Andrew, M.O.C. (ND), p. 175 - CON
 Hon. E. Y. Berry, M.O.C. (SD), pp. 175-6 - CON
 Hon. Archer Nelsen, M.O.C. (Minn.), p. 177 - CON
 Hon. Don Reifel, M.O.C. (SD), p. 170 - CON
 American Meat Inst., pp. 178-9, generally - CON
 P. Loring Reed, Jr., Pres., Boston Wool Traders Ass'n, p.180 - CON
 C. L. Mast, Millers Nat.Federation, p.181 - CON
 Perry Moore, Commission Merchant, p. 183 - CON
 Don F. Magdanz, Nat. Livestock Feeders Ass'n, p. 184 - CON
 O. A. Cooper Co., Humbull, Neb., p. 186 - CON
 R. T. Birdsey, Pres., Birdsey Flour & Feed Mill, p. 187 - CON
 A. L. Doran, Bcon Grain & Seed Co., p. 187 - CON
 J. Allan Mactier, Pres., Neb. Con. Mills, p. 187 - CON
 Paul E. R. Abrahamson, N.D. Wheat Comm., p. 188 - CON
 H. P. Higgins, Jr., N. Am. Export Grain Ass'n, pp.188-9 - CON
 Erwin A. Olson, Chmn., A.D.M. Co., p. 189 - CON
 Llewellyn Watts, Jr., N.Y. Merc. Exch., p. 190 - CON
 J. M. Mehl, Former CEA Administrator, p. 191 - PRO
 Wm. Brooks, Pres., Natl. Grain Trade Council, pp.191-2 - CON
 Robert Jackson, EVP, Am. Textile Mfg. Inst., p. 194 - CON
 Fred H. Husbands, N&L Cottonseed Assn, p. 194 - CON

APPENDIX C

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Similar testimony may be found in subsequent Hearing Reports, reference to which is noted below:

SMALL BUSINESS PROBLEMS INVOLVED IN THE MARKETING OF GRAIN AND OTHER COMMODITIES - HEARINGS BEFORE THE SUBCOMMITTEE ON SPECIAL SMALL BUSINESS PROBLEMS OF THE PERMANENT SELECT COMMITTEE ON SMALL BUSINESS, HOUSE OF REPRESENTATIVES, NINETY-THIRD CONGRESS, FIRST SESSION, JULY 25-26, SEPTEMBER 18, 25, 26, OCTOBER 2, 3 AND 4, 1973

REVIEW OF COMMODITY EXCHANGE ACT AND DISCUSSION OF POSSIBLE CHANGES - HEARINGS BEFORE THE COMMITTEE ON AGRICULTURE, HOUSE OF REPRESENTATIVES, NINETY-THIRD CONGRESS, FIRST SESSION, OCTOBER 16, 17, 18 AND 24, 1973

COMMODITY FUTURES TRADING COMMISSION ACT OF 1974 - HOUSE REPORT ON H.R. 13113, APRIL 4, 1974, pp. 66-67
HEARINGS BEFORE THE COMMITTEE ON AGRICULTURE AND FORESTRY, UNITED STATES SENATE, NINETY-THIRD CONGRESS, SECOND SESSION, ON S. 2485, S. 2578, S. 2387, AND H.R. 13113- MAY 13, 14, 15, 16, 17, 20, 21, and 23, 1974, PARTS 1, 2 AND 3

SMALL BUSINESS PROBLEMS INVOLVED IN THE MARKETING OF GRAIN AND OTHER COMMODITIES - A REPORT OF THE SUBCOMMITTEE ON SPECIAL SMALL BUSINESS PROBLEMS OF THE PERMANENT SELECT COMMITTEE ON SMALL BUSINESS, TOGETHER WITH ADDITIONAL VIEWS, APRIL 1, 1974

INTERIM REPORT TO THE CONGRESS ON THE COMMODITY EXCHANGE AUTHORITY AND/OR COMMODITY FUTURES TRADING COMMISSION BY THE COMPTROLLER GENERAL OF THE UNITED STATES (B-146770) MAY 3, 1974, pp. 23-25

APPENDIX D

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KEY QUOTES

The 1967 study done for USDA's Economic Research Service, looking at the same issue, is most instructive. Some key points and findings:

- Evidence studied (corn, wheat, soybeans from 1955 to 1965) "does not support the hypothesis that 'excessive speculation' causes or is even associated historically with market periods containing unwarranted or undesirable price fluctuation" (p. 35).
- Speculators' transactions often moderate rather than accentuate price volatility (p. 1).
- Margins entail costs which are passed back to the producer or forward to the consumer (p. 1).
- Regarding administrative problems [sic - in setting margins] prime importance should be attached to the difficulty in prescribing general criteria for identifying promptly individual circumstances in which CEA [sic - now CFTC] should establish margins. Equally important would be a set of guidelines which would help the administrator recognize when to remove controls, once they had been established (pp. 7,8).
- "A representative cross-section of producers, traders, processors, and students of the market was consulted. The preponderance of opinion is (was) opposed to the use of margins as a means of controlling price fluctuations. The bulk of the opposition was based on a conviction that margin controls ought not to be used for any purpose but protecting the financial integrity of the market. A minority based their position on a belief that using margins for purposes of price control, would not be effective" (p. 8).

* * * * *

Economics of Futures Trading - Dr. Thomas A. Hieronymus, p. 322:

"An important reason for not granting margin control for the purpose of preventing price excesses is that it would not work. Suppose that a speculative boom gets started and grows on what it feeds on and that the controlling authority recognizes the rise as a price excess. He imposes higher margins. The longs will not have any trouble; they already have profits and experience no difficulty. The shorts will have difficulty since they have losses; it is their capital position that is extended. An increase in margin requirements would force them to buy in short positions, lending further upward impetus to prices. Long speculators do not mind larger margins in rising markets; the shorts do. The thinking of the people who propose governmental control of margin requirements has long since been intriguing.

(over)

APPENDIX D

11

"The most offensive thing about the margin proposal and proposals that would grant government officials power to issue cease and desist orders when they judge price aberrations are incipient is that they would supplant the wisdom of the market with the judgment of the officials and convey the power to manipulate prices. They would permit an official to compel traders to comply with his notions of what price behavior should be. They presuppose that the official could recognize incipient cases of price distortion. This goes back to the difficulty of anticipating price changes. Seemingly erroneous courses of prices often, if not usually, turn out to be quite correct when we gain the advantage of hindsight. The wisdom of the market is greater than that of government officials; this is a basic tenet of a competitive system. Were authority to control margin granted to government, it would be for the purpose of enabling government to cause prices to be something other than they would have been--for the purpose of manipulation. This is the antithesis of competition."

Statement by Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the Committee on Government Operations, House of Representatives, April 30, 1980 (pp. 11,12,13):

"Indeed, I would caution against striking out with hastily conceived restrictive legislation with respect to organized futures markets. Those markets already have some considerable financial safeguards embedded in their structure. One danger from excessive regulation or the imposition of heavy costs is that activity will shift to unregulated channels here or abroad, potentially leaving the markets more vulnerable than before to manipulation or credit weakness.

"Finally, I cannot refrain from emphasizing that the environment of inflation, and the uncertainty and doubts about the future that accompany inflation, provided the fertile breeding ground for the recent speculative activity in commodity markets generally--speculation that reached an extreme form in the case of silver. Stable, well functioning markets ultimately depend upon a sense of stability and confidence in our currency....."

CNS, 3-13-80. Representative Neal Smith (Ia.) in a House speech last Wednesday (3-12) warned that -

"A [sic - commodity] margin increase would be inflationary rather than deflationary. The administration's consideration of such move causes me a great deal of concern. The cost of legitimate futures market hedging already is disturbingly higher than ... 1 year due to interest rate increases. Higher margins would add to that while raising production costs for processors and marketing costs for elevators and other grain handlers."

APPENDIX ETO AMEND THE COMMODITY EXCHANGE ACT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON DOMESTIC MARKETING
AND CONSUMER RELATIONS

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

EIGHTY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 11788

APRIL 4, 5, AND 6, 1906

Serial CC

Printed for the use of the Committee on Agriculture

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STATEMENT OF DR. ROGER W. GRAY, PROFESSOR, STANFORD UNIVERSITY, ECONOMIST IN FOOD RESEARCH INSTITUTE; ACCOMPANIED BY JAMES A. WALSH, VICE PRESIDENT, CONTINENTAL ILLINOIS NATIONAL BANK & TRUST CO. OF CHICAGO; AND MAURICE JOHNSON, EXECUTIVE VICE PRESIDENT, FIRST NATIONAL BANK, KANSAS CITY, MO.

Dr. Gray, Mr. Chairman and members of the committee, my name is Roger W. Gray. I am a professor at Stanford University and an economist in its Food Research Institute. I am appearing here in behalf of the First National Bank of Kansas City; Commerce Trust Co., Kansas City; Continental Illinois National Bank & Trust Co. of Chicago; Northwestern National Bank of Minneapolis; First National Bank of Minneapolis; and the First National Bank of Chicago.

I should like to present to you the gentlemen sitting with me. To my right is Mr. Maurice Johnson, executive vice president of the First National Bank of Kansas City, Mo., and to my left is Mr. James A. Walsh, vice president of the Continental Illinois National Bank & Trust Co. of Chicago.

APPENDIX F

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Published References to Margins:

Concepts on Profits in Commodity Futures Trading by Houston A. Cox, Jr., 1972, by Reynolds Securities, Inc., pp. 75-6, 192

Evolution of Futures Trading, Harold S. Irwin, 1954, Minor Publishers, Inc., pp. 35, 80

Commodity Futures As a Business Management Tool, Henry B. Arthur, 1971, Div. of Research, Graduate School of Business Administration, Harvard University, pp. 27-28, 32-36, 375-376

Commodity Exchanges and Futures Trading, Julius Bear and Olin Glen Saxon, 1929, 1935, 1949, Harper Bros., pp. 171-176, 181, 306-309

The Dow Jones Commodities Handbook, 1977, Edited by John A. Prestbo, p. 194

Margins, Speculation and Prices in Grains Futures Markets, Economic Research Service, U.S. Department of Agriculture, Dec. 1967 (Prepared by Robert R. Nathan Associates, Inc.), pp. 155-200, 207, 215, 220

Commodity Speculation with Profits in Mind, L. Dee Belveal, 1967, Commodity Press, a div. of Belveal & Co., Inc., pp. 19, 42-45, 53, 250-251, 266

Commodity Exchanges, Julius Bear and George Woodruff, 1929, Harper Bros., Publishers, pp. 47, 280-283

Economics of Futures Trading, Dr. Thomas A. Hieronymus, 1971, Commodity Research Bureau, Inc., pp. 42-43, 62-65, 244-245, 318-322

The Commodity Futures Game, Tewles, Harlow and Stone, 1974, McGraw Hill Book Co., pp. 17-18, 41

Organized Commodity Markets, Vol. 155, Part 1, 1931, The Annals of the American Academy of Political Science, pp. 104-107, 130, 142

STATEMENT OF COMMODITY EXCHANGE, INC.
BEFORE THE HOUSE SUBCOMMITTEE ON
CONSERVATION AND CREDIT

Commodity Exchange, Inc. ("Comex" or the "Exchange") is the world's largest metals exchange. Futures contracts in silver, gold, copper and zinc are bought and sold on Comex. In addition, Comex has recently developed a financial instruments futures market for the trading of 90-Day Treasury Bill futures contracts and GNMA futures contracts and two applications are pending before the Commodity Futures Trading Commission ("CFTC") to trade in futures contracts on treasury notes.

We appreciate this opportunity to testify before the Subcommittee. Our comments will be addressed to three issues: (1) the self-regulatory actions of the Exchange in the silver market from September 1979 through March 1980; (2) margin on futures contracts with particular focus on the appropriate entity to establish the same; and (3) some brief general observations on jurisdiction over the futures industry.

Summary of Comex Silver Market Activities - September 1979
through March 1980

The silver market on Comex has for many years been viewed by the silver industry as the principal world marketplace for hedging and for price discovery. Each silver contract traded on Comex represents 5,000 troy ounces of silver (plus or minus 6%) of at least .999 fineness. Six depositories licensed by Comex are authorized to store silver for delivery against Comex futures contracts and to issue warehouse receipts representing such silver. There are more than fifty approved brands of silver deliverable against Comex silver futures contracts.

The Comex silver market is utilized not only by United States interests but also by foreign interests. However, silver is traded worldwide, not only on Comex, the

Chicago Board of Trade and the Midamerica Commodity Exchange, but also in London, Zurich and Hong Kong.

We have previously furnished to the Subcommittee the document prepared by Comex and Comex Clearing Association Inc. entitled Chronology of Activities Relating to the Silver Market from September 1979 through March 1980, ("Chronology"). That document contains a detailed description of the activities of Comex and the Comex Clearing Association during the period in question and I respectfully request that it be included as part of the testimony of Comex at these hearings. Let me now summarize the most significant issues covered in the Chronology.

In 1974, Nelson Bunker Hunt and W. Herbert Hunt (for purposes of this statement, Nelson Bunker Hunt and W. Herbert Hunt, together with other members of the Hunt family and various corporations in which the Hunts have a material interest are collectively called the "Hunts" or the "Hunt Group") acquired a substantial position in silver futures contracts on Comex. During the subsequent five years, they maintained that position and continually moved it forward to more distant maturities, without incident. The Control Committee of Comex and the Board of Governors of Comex continually reviewed and monitored the Comex silver market, with an awareness of the positions of the Hunt Group. No evidence was discovered during that period which might have suggested the presence of any squeeze, corner or other attempt to manipulate the silver market. The market was maintained in an orderly fashion and each maturing futures contract liquidated properly.

From September 1979 through March 1980, the silver market at Comex came under increasingly intensive scrutiny at Comex as the result not only of the activities of the Hunt Group but also the introduction of additional substantial foreign participants ("Foreign Investors") into the market.

In late August and early September the Foreign Investors obtained substantial futures positions. They then proceeded to take large deliveries of silver on Comex from September through December 1979 (as did the Hunts), and shipped substantial quantities of silver overseas. The large positions combined with the large deliveries and shipments caused Comex significant concern. During those seven months, Comex was in continual contact with representatives of the Commodity Futures Trading Commission ("CFTC") for the purpose of exchanging information about large participants in the silver market and discussing the possible need for exchange action. Information was also exchanged during that period with the Chicago Board of Trade.

In the view of Comex, the acts of the CFTC during the period were prudent and enabled Comex satisfactorily to discharge its self-regulatory obligations. The fact that the CFTC's role was advisory rather than action oriented does not change that view. The CFTC was thoroughly informed and prepared to act at any time that the Exchange failed to fulfill its self-regulatory responsibilities. Fortunately there was no need for CFTC action because the Exchange did fulfill its self-regulatory duties. In fact, at a January 8, 1980 CFTC surveillance meeting attended by exchange officials, the Commissioners commended Comex and the CBOT for having acted responsibly and made no suggestions for further exchange actions.

A series of actions were taken by Comex during the period in question in an attempt to: (1) avoid the possibility of any manipulation, squeeze or corner in the silver market; (2) continue the viability of the silver futures market; (3) insure the continuing financial integrity of the marketplace through increased margin requirements; (4) enable silver futures contracts to liquidate in an orderly fashion; (5) reduce the overall open interest in silver; and (6) curb potentially excessive speculation in the silver market. Original margin require-

nents were increased on six occasions, maximum permissible daily price fluctuations were increased three times, position limits were imposed and ultimately trading was permitted for liquidation purposes only.

From September 1979 through March 1980, the Comex Control Committee, chaired by Dr. Andrew Brimmer, and the Comex Market Surveillance Department, headed by Dr. David Rutledge, were monitoring the Comex silver market on a daily basis. In addition, on October 4, 1979, the Board of Governors of Comex established a Special Silver Committee, to consist only of Board members having no interest in the silver market, to monitor the silver market and to take all action necessary to deal with the potential congestion developing in the silver market. The activities of that Committee from October through December 1979, with the assistance of the Comex Control Committee and the Comex Market Surveillance Department, permitted the December silver contract to liquidate in an orderly fashion.

On January 7, 1980, the Board met to review the then existing situation in the silver market with a particular view toward the size of positions of the Hunt Group and Foreign Investors in 1980 maturities, and the extent to which new speculative interests were appearing in the silver market. The Board became concerned that the available deliverable supply of silver in Comex licensed depositories: (1) was to a great extent controlled by the Hunt Group and Foreign Investors; and (2) was not likely to increase materially during the first six months of 1980. As a result of those concerns and the fact that the Hunt Group and Foreign Investors maintained substantial existing positions in the world silver market and substantial inventories of silver, the Board determined to impose position limits on the beneficial owners of silver futures contracts.

For approximately two weeks, members of the Board observed activities in the silver market with the position limit rule in place and became increasingly concerned about

the following events which seemed to be taking place: (1) new accounts were being opened in corporate and other names which might be related to presently existing positions in the silver market as a potential method of abusing and circumventing the position limit rule; (2) large positions in the marketplace were not being liquidated or moved forward; (3) the presence of large interests in the market seemed to be discouraging hedgers and other speculators from participating in the market; and (4) acquisition of silver through the London silver market and deliveries made on Comex of physical silver in December 1979 reflected a continuing desire of the Hunt Group and Foreign Investors to obtain supplies of silver potentially in excess of those available through Comex licensed depositories.

As a result, on January 21, 1980 the Comex Board ordered that trading in all silver futures contracts only be permitted for liquidation and that no new positions be acquired except by short sellers whose principal purpose was to effect delivery of silver upon maturity of their contracts (as an obvious method of bringing more silver into Comex licensed depositories).

Since the open interest and the size of the large positions started to decline sharply and since representatives of the trade advised Comex that more silver was becoming readily available through the refining process, the liquidation only order was lifted in February 1980 and limited new trading was permitted. During the entire period silver contracts liquidated in an orderly fashion. During February and March the Comex Compliance Department investigated potential violations of the Comex position limit rule and initiated disciplinary proceedings against a number of its member firms which are presently in progress.

On March 26, 1980 and March 27, 1980 the Board met to consider issues that were arising as a result of the large margin calls that were being made daily by Comex Clearing Association. Even though all clearing association

margin calls had been timely satisfied (and, in fact, were timely satisfied throughout the entire period), several clearing members were concerned that the Hunts would experience problems in satisfying their margin calls in a rapidly declining market.

At that time, original margin requirements for the Hunts and the Foreign Investors were \$60,000 per contract, a margin which had been established when the value of a silver contract in a volatile market was \$200,000. Because the value of a silver contract by that time had declined to \$75,000 and thus reduced the potential for volatility, the Board reduced the original margin requirements to \$40,000 per contract, thus freeing up additional funds for use in the payment of daily variation margin. In fact the original margin requirements for the Hunts at Bache, Halsey, Stuart and Shields on approximately 4,000 silver contracts were reduced by \$80,000,000 which sum was thereafter used to satisfy daily variation margin requirements.

Throughout all of the activity and anxiety of the seven month period, no customer was victimized by default, no brokerage firm collapsed, the financial viability of silver futures contracts was maintained and the silver market survived.

Margin on Futures Contracts

During the past several weeks suggestions have been made that margin on futures contracts should be established by the CFTC or the Federal Reserve Board, not by futures exchanges. Comex believes that such action would potentially destroy any futures markets subjected to such regulation.

We believe this Subcommittee should focus on five particular points relating to futures margins: (1) the purpose of margins on futures contracts; (2) their dramatic distinction from securities margins; (3) the manner in which the Federal Reserve Board has used its authority to establish

securities margins; (4) the successful history of Comex in establishing margins; and (5) the legislative history surrounding the issue of authority over futures margins.

Attached hereto is a detailed statement on the margin issue with particular emphasis on the legislative history of, and rationale for, continuing Congressional refusal to grant margin authority over futures contracts to any federal agency. Several points, however, require emphasis.

The economic purpose of and justification for commodity futures trading is to shift the risk of adverse commodity price changes from those who do not wish to bear such risks (hedgers) to those who are willing to bear such risks (speculators). Since the risk of adverse price changes imposes costs on the trade that are part of their cost of doing business, an efficient price-risk shifting system benefits the entire economy by ultimately lowering costs to the producers, processors, users and consumers of commodities.

Commodity futures trading is not the only way in which price risks can be shifted. Other methods of price-risk shifting include forward contracts, long term supply agreements and inventory adjustments. Experience has shown, however, that an efficient futures market permits hedgers to shift price risks at a lower total cost than the alternative methods.

One of the key advantages of an efficient futures market over alternative price-risk shifting mechanisms is its liquidity. A liquid futures market enables hedgers to obtain price insurance more quickly and less expensively than in any other marketplace. Less liquid markets involve higher transaction costs such as wider bid-ask spreads and an inability to accept large orders from hedgers without significant adverse price movements.

It is essential to recognize, therefore, that in establishing futures margin requirements, the liquidity of the marketplace must not be so impaired as to render the

market incapable of affording hedging opportunity to its participants. Clearly a 100% margin requirement would absolutely avoid defaults, but it would also completely eliminate the speculator from the marketplace, destroying liquidity and, therefore, destroying the market.

Another advantage of the futures market over alternative price-risk shifting mechanisms is its ability to limit the risk of default by one of the parties. In contrast to the forward markets, the original margin and mark-to-market requirements of futures markets provide a higher degree of security against the risk of default.

In a forward market, the difference between the forward contract price and the market price is typically not paid until the maturity date of the contract. Consequently, large price movements can and do call into question the financial ability of one of the parties to the contract to perform at maturity. This risk is demonstrated by the extensively publicized forward contract between Engelhard Minerals and the Hunts. The default risk is so significant that hedgers prefer the greater security of an efficient futures market.

Daily marking-to-market of futures contracts requires, in effect, that cash payments be made from and to market participants in an amount equal to that day's changes in the futures market price. Consequently, instead of a four month or a twelve month forward contract risk, for example, the risk in a futures contract is reduced to the value of one day's price fluctuation.

To further reduce the daily price risk, commodity exchanges have instituted a system of original margin requirements. Commodity exchanges require market participants to deposit in advance cash or cash equivalents whose value is equal to or greater than expected daily price fluctuations. For example, when original margin for silver was \$60,000, the value of a contract could decline by as much as \$12 an ounce (e.g. $\$12 \times 5000 \text{ oz.} = \$60,000$) and the

integrity of the contract could be assured even if no daily variation margin was paid during the \$12 decline. It is this and other reductions in the default risk, which the commodity futures exchanges make possible, that significantly lower the cost of price insurance for hedgers.

From this perspective it becomes clear why commodity exchanges endeavor to set margins that are neither too high nor too low. If original margins are set too high, hedgers and speculators will, because of the limited availability of capital, be less able to transfer price risks efficiently; the cost of price insurance, in terms of the capital required, will be too high for efficient hedging. If on the other hand, original margin requirements are set too low, the increased risk of default will make the futures market less attractive to hedgers who use the futures markets to reduce their price risk. The solution adopted by the futures exchanges has been to establish margins based upon the volatility of the contract so that a customer's failure to meet a daily variation margin call will enable his broker to liquidate the contract and have sufficient original margin to satisfy the customer's market obligations.

The Subcommittee should also keep in mind the difference between margin on securities and margin on futures contracts. Margin on securities arises at the time that a purchase of securities has been fully consummated. The customer is required to pay the entire purchase price and a portion thereof is advanced by the brokerage firm. Thus, a true extension of credit exists with its attendant inflationary overtones. However, margin on a futures contract is dramatically different. At the time the futures contract is entered into, the commodity is not purchased. In fact for over 95% of all futures contracts, the commodity is never purchased. The margin is merely a good faith deposit designed to insure the financial integrity of the futures contract and the financial ability of the potential purchaser to meet daily margin calls. Thus, no credit is ever extended when a futures contract is purchased or sold.

It is only when a commodity futures contract results in delivery of the physical commodity (which is a relatively rare event) that a possible impact on the amount of credit in the economy occurs. Credit increases occur through the futures markets only to the extent that lending institutions are willing to finance deliveries under the contracts and possession of the physical commodities. Thus, if Federal Reserve Board regulation of this kind of credit extension is appropriate, it should be directed not at the commodity futures exchanges but at the lending institutions that finance the purchase, delivery and possession of the physical commodities.

In reviewing the history of the Federal Reserve Board in establishing securities margins it is interesting to note that there has not been any change in the 50% stock margin requirement for over five years. During the seven months in question, Comex changed original margin requirements regularly to keep pace with a dramatically moving and volatile silver market. To establish futures margins, regular review of futures markets and a constant awareness of economic factors within the markets is essential. No entity is more appropriate to discharge that responsibility than futures exchanges. As evidence of the effectiveness of futures exchanges in establishing margins, it should be noted that there has never been an incident of brokerage firm failure resulting from commodity defaults.

The Chronology of silver events contains a detailed description of the method by which Comex establishes original margin requirements for futures contracts. We submit that such method, combined with Comex's vigilance in regularly reviewing and revising original margin requirements and the absence of defaults on Comex throughout its almost fifty year history, demonstrates Comex's ability to effectively set margins without government oversight or intrusion.

Jurisdiction over the Futures Industry

Congress devoted considerable attention in 1974, and again in 1978, to the issue of regulatory jurisdiction over futures trading. After carefully weighing all the arguments, Congress decided in 1974 to grant exclusive jurisdiction to the CFTC, and specifically reaffirmed that decision in 1978.

There are a host of very convincing reasons behind Congress' 1974 and 1978 determinations. Shared jurisdiction over the futures industry would: (1) wreak havoc on the highly sophisticated and economically vital futures markets; (2) impose severe financial burdens on the users of those markets; (3) cause the expenditure of tax dollars without any concomitant benefits; (4) conflict with the Administration's policy of decreasing regulatory burdens on industry and the public; (5) create an inherent regulatory conflict of interest (if jurisdiction were vested in any policy-making agency); and (6) quite possibly result in a change in Congressional oversight jurisdiction, thus negating the benefits of the experience and expertise of the House and Senate Agriculture Committees in the complex commodity futures industry.

We have attached to our testimony a separate statement discussing in detail the rationale behind Congress' decisions in 1974 and 1978 to give the CFTC exclusive jurisdiction.

Recently, other Congressional committees and other federal agencies have renewed their attempts to gain a jurisdictional foothold in the futures markets. Such attempts should be rejected as they were in 1974 and 1978. The only new factor added to the equation since Congress' previous considerations -- more years of regulatory experience in the Commission -- merely adds weight to the arguments in favor of exclusive CFTC jurisdiction. The

Commission has experienced the growing pains of any new federal agency in a complex and far-reaching industry. However, Comex believes that with the expertise developed at the CFTC and the CFTC's reauthorization experience its early problems are becoming history. We hope the Committee will oppose any proposals to dilute the Commission's jurisdiction and discard the benefits of the Commission's hard-won experience and expertise.

Conclusion

In summary, a careful review of the recent experiences in the silver market, and the exchanges' actions, demonstrates that the self-regulatory system envisioned by Congress does work and works very effectively. The carefully weighed decisions of the Congress in 1974 and 1978 concerning jurisdiction, margin authority, and the respective powers and duties of the Commission and the exchanges have been proven correct. Both had the necessary tools within the existing statutory framework to deal with all the problems that were encountered and the wisdom to use those tools with restraint.

STATEMENT OF BENNETT J. CORN
President
Coffee, Sugar & Cocoa Exchange, Inc.

Before the Subcommittee on Conservation & Credit
Committee on Agriculture of the House of Representatives
May 22, 1980

Mr. Chairman, I welcome the opportunity to testify before this Committee. As suggested in the press release announcing the hearings, I shall address (1) the adequacy of exchange self-regulation, (2) the question of potential conflicts of interest in a self-regulatory situation, (3) the proposals for new regulatory authority over margins, and (4) the ability of the CFTC to regulate the commodities markets.

1. Adequacy of Exchange Self-Regulation.

The Coffee, Sugar & Cocoa Exchange is the only exchange in America that exclusively trades contracts for the future delivery of commodities that are produced abroad and that are all the subject of active trading in foreign markets. In fact, our market and the foreign markets together really constitute a single, world marketplace that has several points of entry, of which New York is only one. Therefore, as we discuss alternatives of regulation, we should keep in mind that any actions that have a restrictive effect on trading activities here will inevitably make other points of entry to the world market more attractive.

The Exchange has been in existence since 1882. Until 1975, it successfully regulated its markets for nearly a century without governmental regulations. We have taken our self-regulatory role very seriously, and since 1975 we have committed a great deal of time and resources to meeting the new responsibilities that were placed upon us.

One reflection of that fact can be seen in the dramatic growth in the size and professionalism of our staff. In 1975, when federal regulation was first im-

posed upon us, we had only 39 employees, all of whom performed merely clerical functions except for two or three people involved in administration. Today, we have doubled the size of the staff and greatly upgraded its professionalism. In 1975, our economic research was performed by a single statistician. Today, the Exchange has two economists, two statisticians, and a research assistant. In 1975 there was no formal organization charged with performing audits and investigations of members. Today, the Exchange has a compliance department with sixteen employees, including investigators, auditors, management staff, and others.

In 1980, unlike 1975, we have an in-house counsel to assist us with day-to-day legal questions and to improve the Exchange's ability to investigate and discipline its members. And we have recently joined with six other commodity exchanges and the New York Stock Exchange in a joint surveillance program under which our members are audited on a regular basis and information is shared among the participating exchanges.

I believe that the recent events in the silver market prove the responsiveness of our Exchange to the need for properly regulating our marketplace. For four consecutive days after the first rumors were heard that major problems might be developing in the silver market, the Exchange and/or its affiliated Clearing Associations held Board or Committee meetings running long hours late into the day. We knew that a number of our members had large commitments in the silver market as well as in our markets. We were keenly sensitive to the fact that if any of our members ran into financial difficulties in silver, the effects could spill over into our markets. Representatives of the clearing members affected were called in repeatedly, and their financial positions were closely monitored. Our surveillance staff sent auditors out to

member firms, and we sought and obtained a steady flow of information from the CFTC, from other exchanges and from various banks. Finally, as one more safeguard, the Exchange's affiliated Clearing Associations called upon their members to turn over an increased proportion of customer margins held by them. The call was issued Friday afternoon, March 28, and by Monday noon, March 31, over sixty million additional dollars had been deposited with the Clearing Associations.

If at any time we believed that any of our members were in trouble, we were fully prepared to take whatever action seemed appropriate to protect the financial integrity of our markets, including the forced liquidation of positions, if necessary.

All our actions in that last week of March were carried out without government prodding or intervention of any kind. We acted because of our sense of self-regulatory responsibility -- responsibility to both the public and, to be perfectly frank, to ourselves. For if the truth be told, the strongest motivating force for strong, effective self-regulation is the enlightened self-interest of our members.

2. Potential Conflicts of Interest.

This Committee has sought testimony regarding the question of whether the system of self-regulation presents a possible conflict of interest for industry members who serve on exchange boards and committees.

The Exchange is dependent on its members to give it the necessary expertise to carry out its regulatory duties. Frequently, the Exchange must make decisions with regard to market conditions: decisions on the adequacy of deliverable supply, for example, or the potential market impact of certain developments. Such decisions require the exercise of informed judgment. No one in government -- and for that matter, few members of the Exchange staff --

has the knowledge and the experienced "feel" for the markets that is necessary.

Of course, the fact that Board members may have an interest in particular market situations does raise the potential for conflicts of interest. However, we have a number of safeguards to prevent these potential conflicts from affecting the decision-making powers in ways that are adverse to the marketplace. For example, when emergency market conditions are discussed, Board members of our Exchange are required to disclose whether they hold positions and, if so, on which side of the market. Almost invariably there will be persons present holding positions on opposite sides. When sensitive votes have been taken, interested parties have excused themselves from voting. In addition, the Exchange Board of Managers has a public member who is a distinguished figure in the academic community, and who is neither a member of the Exchange nor involved in any of the trades the Exchange services.

3. Proper Margin Controls.

Several proposals now before this Committee and other committees of Congress would place standby authority over commodity margins with an agency or department of the federal government. These proposals misconceive the proper functions of margins in the commodities industry and would result in serious adverse consequences, particularly in the case of commodities such as ours that are traded in the world marketplace. Congressman Poage, then Chairman of this Committee, stated the case very well in 1974 when he spoke in opposition to a proposal made then to enable the CFTC to fix margins. He said:

"As one begins to study it one finds that this margin is not for the protection of the individual who is buying or selling the contract; this margin is for the protection of the exchange. It is for the protection of the exchange that is handling these deals because the exchange guarantees the performance of the contract, and if there is failure on the part of a contract then the

exchange must make it good. The exchange makes it good through these margins. So we leave the control of the amount of the margin to the exchange itself. We authorize the exchange to set margins, and to change margins as conditions change, and they may change hourly. Conditions may change very promptly.... But then the people who are going to be directly affected are there, and can take steps to protect themselves. If, on the other hand, we were to take away the authority on the part of the exchanges to make these daily and hourly adjustments on margin, we would take away from that exchange the very essential power to protect itself from bankruptcy.... We should leave it in the hands of the exchange so that they can protect themselves and everybody who deals with them." 120 Cong. Rec. H2953 (daily ed. April 11, 1974)

Congress agreed with Mr. Poage then, and there is no reason to change that judgment now. Certainly there were many tense moments as the recent silver crisis was being worked out, but no one has shown how governmental control over margins would have led to any better solutions.

Much has been said recently on the question of whether excessive credit helped to inflate the speculative bubble in silver. But exchange margins do not represent extensions of credit -- they are merely security deposits. Even if exchanges were to require 100% margin, exchange margin levels would have little effect on overall market prices of commodities, so long as large traders are free to finance inventories, to engage in margin-free forward transactions and to borrow monies to meet futures margins from bankers or brokers or elsewhere. In other words, if the problem is perceived to be excessive credit, exchange margin levels are not the way to address that problem.

I see a number of serious problems that could result from now giving margin authority to a governmental agency.

First, and perhaps most important from the standpoint of an international exchange such as ours, burdensome margin regulation will inevitably result in driving trading abroad. A person buying coffee, sugar or cocoa on the world market -- whether he is located here or abroad -- has ready

access to the foreign exchanges as well as our Exchange to hedge his purchases. There are no governmentally-imposed margins -- indeed, very little governmental regulation of any kind -- on the foreign exchanges. If we make American exchanges less attractive, it follows that the foreign exchanges -- which, as I said before, are really part of one global market -- will appear more attractive. Not only will we see an exodus of capital to these foreign markets. At the same time, we will lose regulatory control over the trading that moves outside of our borders, even though that trading will directly influence market conditions within the United States.

Second, any such authority would likely often be asked to raise margins above the levels exchanges would set. That would raise the cost of doing business for the commercial interests who trade in futures contracts in order to hedge themselves against the risk of price fluctuations. To the extent that these commercials experience increased financing costs, they will have to pass these costs on to their customers. To the extent that they decide not to hedge, their increased risks will likely also be reflected in increased costs to their customers. Excessive margin levels also present the risk of driving away the speculators who are necessary to provide liquidity to the marketplace, especially when it is most volatile.

Finally, margins that are fixed by the government are not likely to respond quickly to rapidly changing market conditions. Such inflexibility would ignore one of the most important characteristics of margins as they are currently regulated: their flexibility in the face of changing conditions in the marketplace. Margin levels are constantly being reviewed by exchanges and clearing associations to see that their primary function -- protecting the financial integrity of the marketplace -- is being fulfilled, without,

at the same time, driving necessary liquidity from the market-place. The exchanges are uniquely qualified to engage in this continuous balancing and "fine-tuning" of margins. For "fine-tuning" is critical. It is something that government is not equipped to do, both because of its lack of necessary expertise and because of its inability to act quickly.

4. Adequacy of CFTC Regulatory Powers.

The CFTC has pervasive regulatory powers over all the commodity exchanges in the United States. These include extraordinary powers to order exchanges to take whatever actions the Commission deems appropriate to deal with market emergencies. The CFTC also has those emergency powers even over margins. Taken together these powers are sufficient and no more are needed.

However, while we are on this subject, let me mention a unilateral point. Recently the Court of Appeals for the Seventh Circuit ruled that Congress intended the exercise of CFTC emergency powers to be immune from judicial review. The Supreme Court denied certiorari. With all due respect, we cannot believe that Congress really intended to give such massive powers to a governmental agency such as the CFTC absolutely free of any judicial review whatsoever. In considering any legislation in this area, we urge the Committee to consider this issue and to restore the fundamental right to obtain judicial review of CFTC emergency decisions.

Aside from that, Mr. Chairman, the present regulatory framework works. There is no reason to change it.

POIROT FARMS, Inc.

NEW CASTLE - GOLDEN EAGLE SEEDS
 1937 - 1938 AND OTHER NEW CROPS
GOLDEN CITY, MO. 64748

C. G. Stone, Inc.

A. J. Stone, Vice-President

Chairman Stone
 C.F.T.C.
 Washington D.C.

March 1, 1960

Dear Mr. Stone,

I was until recently owner of four February silver contracts on the C.F.T.C. in Chicago. I intended to take delivery on the contracts for two reasons:

1.) I believe silver is a very good store of value and likely to appreciate in value.

2.) I needed to take delivery so as to convert a short term capital gain into a long term gain.

My contract calls for delivery of silver by the one "short" or excuses are allowed for failure. The penalty is spelled out in the contract, "Broker is empowered to go into the open market and buy the commodity in question and deliver it and the party 'short' shall be liable for all costs."

However, in this case, it was the members of the C.F.T.C. who were "short." They are also the ones who are empowered to declare an "emergency" and thereby release themselves from their legal contracts. The contention that there is or was no deliverable silver available is pure rubbish. They do not want to pay the price to make good on their contracts. If I were the one short, would I be released from my obligation because it was expensive for me to fulfill it?

I have been summarily sold out of my February contracts by order of the C.F.T.C. (hereafter referred to as "shorts") at whatever price was offered by said "shorts." I was not permitted to take delivery on any of the contracts as I intended when I entered into the agreements. Incidentally, the price I received was lower by many thousand dollars each time than I would have received in the London or Zurich markets either the day of the sale or the day following.

I have come to the following conclusions:

1.) The commodity markets as presently constituted are run for the purpose of fleecing the general public to the benefit of a few very rich individuals.

2.) Part of the purpose is to try to keep the prices of commodities as low as possible. In this they are encouraged and abetted by bureaucrats such as you, either with the sanction of our government or due to the influence of the people whom you're supposed to be regulating.

3.) The term "free market" as used in these contracts means free only as long as things are going according to plan. As soon as some of the "establishment" begins to hurt, an "emergency" occurs and then we have a captive market. This apparently with your blessing, Mr. Stone.

4.) There is never an emergency when a commodity is falling day after day due to excessive short selling. I have seen my farm prices driven down far below the cost of production for years at a time without any "emergency" occurring. Example: The price of silver was held down for nearly 20 years by selling of the U.S. government and by the silver "shorts." As recently as two years ago there were over 100,000 contracts in the two markets. That's over 1 billion ounces Mr. Stone! That's twelve years of world production! Yes, if someone decides to buy or 1 billion ounces there will be a short emergency! These people who were doing this selling to keep prices down were fanatics, but why not, they had the U.S. government helping them. Now you apparently are going to come to their rescue and help them escape from the trap of their own making. If I'm going bankrupt because of my own stupidity, can I rely on "Big Brother" to come to my rescue?

5.) You are derelict in your duty as head of the C.F.T.C. either through incompetence, or neglect, or you have been unduly influenced by some wealthy people on the short side of the silver market.

Sincerely,

Severin E. Poirot

CFTC REGULATORY AUTHORITY REVIEW

THURSDAY, MAY 29, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSERVATION AND CREDIT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 1301, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Harkin, Huckaby, Calkins, Hance, Richmond, Baldus, Bedell, Panetta, Daschle, Madigan, Coleman, Marlenee, and Hopkins.

Also present: Representatives Rose, Fithian, Wampler, Symms, and Johnson, members of the full committee; and Representative Neal Smith of Iowa.

Staff present: Fowler West, staff director; Robert M. Bor, chief counsel; John E. Hogan, counsel; Robert T. Lowerre and J. Robert Franks, associate counsel; Glenda Temple, clerk; Gary Norton, Robert Cashdollar, James Johnson, Wayne Fletcher, Rita DiSimone, Kathleen Garvin, and Bernard Brenner.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. JONES of Tennessee. The Subcommittee on Conservation and Credit will come to order.

Before we have a witness, I have a statement I would like to read and at the same time I will give an opportunity to any member of the committee to say what they might.

As many of you know who are here today, the subcommittee is continuing its hearings regarding the possible need for amendments to the Commodity Exchange Act and the adequacy of existing regulatory authority of the Commodity Futures Trading Commission (CFTC) in light of the recent market developments, especially in silver.

The subcommittee began oversight hearings on February 12, 1980. At that time the CFTC, the Fed, the Treasury and the SEC seemed to be telling us that all was well on the regulatory front. By the end of March the silver market had collapsed and these same agencies seemed to be engaged in a public dispute over the matter.

Last week we heard from those agencies, from brokerage houses, the exchanges and other witnesses. This week we will hear from witnesses who could not attend last week's meeting, including the Hunt brothers.

Specifically, the subcommittee is exploring the question of whether or not the CFTC has sufficient authority to adequately regulate commodity futures trading. One bill to grant CFTC stand-by authority to set margin requirements has already been introduced by Representative Dan Glickman who is a member of this subcommittee.

The hearings are focusing as well on other regulatory matters, including speculative position limits, the adequacy of selfregulation by the exchanges, possible conflicts of interest within the industry and, finally, CFTC's responsibility to prevent market emergency situations.

Nelson Bunker Hunt and W. Herbert Hunt were major players in the recent silver market situation. Their appearance today should help us sharpen our judgment as to if or how the rules of the game should be changed.

No doubt the members of this subcommittee have a better understanding of the futures market than any others on the Hill. Over the years we have grown to appreciate its complexities and have grown cautious of quick-fire solutions. At the same time, I am rapidly losing patience with having to investigate critical market situations once or twice each year.

American commodity futures trading markets have two basic purposes—to allow for the transfer of risks through hedging and for price discovery. Speculation is a necessary element in accomplishing these goals. But speculation alone is not a market objective and unless individual commodity markets serve an economic purpose, they cannot be supported by this committee.

Ours is a legislative mission. We are neither prosecutors nor judges. The matter of whether or not to invest further regulatory authority over the Nation's economy within the Federal establishment is an important point. Just as important, however, is the necessity for confidence in our market—confidence that they fairly reflect the forces of supply and demand; confidence that no one—even the wealthy Hunt family—can exercise control over our markets for personal gain.

For today's hearings, I am instituting stringent guidelines designed to be as fair as possible to witnesses and to subcommittee members. I ask your full cooperation in this matter.

First, we have one witness left from last week's Friday session which was canceled. Mr. Amstutz, representing the National Feed and Grain Association, will testify. Then I will entertain any questions from subcommittee members to Mr. Amstutz.

Second, we will hear the statement of the Hunt brothers and question them.

I ask both Mr. Amstutz and the Hunt brothers to keep their oral remarks to less than 10 minutes. The complete written statement will be placed in the record, and in case you want to summarize it, it will be fine with us.

Third, each member of the subcommittee will have 5 minutes for questioning and we will go as many rounds as we can with the objective of a 1 p.m. adjournment.

I will enforce the 5-minute rule and ask the clerk to operate the signal lights. And I want to tell you now that when the red light comes on, your time is up.

I ask any other members of the subcommittee if they have statements.

Mr. Harkin?

OPENING STATEMENT OF HON. TOM HARKIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. HARKIN. Thank you, Mr. Chairman.

I certainly concur in what you have said. I think these hearings this morning are going to be good not only for us but for the public. It seems that what we witnessed in terms of the silver trade is the age-old maxim, if you are big enough, the rules don't apply.

As Business Week magazine said a couple weeks ago, the Federal Reserve Board—

Bent its own rules that discouraged banks from making loans for speculative activities in commodity markets in helping to bail out the Hunt brothers from their speculation in the silver market.

What bothers me is that 3 years ago these same brothers were involved in putting a squeeze in the soybean market when they had holdings on futures contracts amounting to about 24 million bushels in April 1977. The individual limits on holdings of soybean contracts of 3 million bushels was far exceeded, the CFTC said.

In view of this history of Hunt speculation, it is surprising that the brothers were able to buy all that silver with borrowed funds while the CFTC and other Government agencies sat quietly by.

So I think it is incumbent upon us to ask the hard questions and to see whether or not the CFTC needs to be beefed up. Do they need more authority, do they need more people?

It seems to me that if we are going to have a functioning futures contract business in this country, then we all have to play by the same rules. The predatory speculative activity engaged in by the Hunts based on sheer financial power gives free enterprise and competitive capitalism a bad name, and when the institutions of government appear to support such antisocial behavior and shield the perpetrators from the penalties of the marketplace, then the public needs to become cynical about the system.

I believe the futures system in this country plays a vital role in protecting our farmers and producers and I don't want to see them become cynical about the system.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Harkin.

Mr. Madigan, the ranking member of the subcommittee.

Mr. MADIGAN. Mr. Chairman, thank you, very much. I have no opening statement. I am anxious to get on with the witnesses in view of the time limits and the time constraints that we are under. I would prefer to forego making any opening statement so we could proceed.

Mr. JONES of Tennessee. Thank you, Mr. Madigan.

Mr. Glickman?

OPENING STATEMENT OF HON. DAN GLICKMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. GLICKMAN. Thank you, Mr. Chairman. I previously have made an opening statement. My only comments today would be the following:

As I view it, the purpose of our hearing is not necessarily to castigate any parties because I don't think that there have been any real allegations that Mr. Hunt or Mr. Hunt, the brothers, have violated any laws, but determining whether the CFTC and other regulatory bodies have sufficient regulatory or legislative power to deal with the situation and determine whether there is a need for additional regulation or legislation.

I tend to disagree for a moment with my colleague from Iowa. I am not sure the issue is, if you are big enough, the rules don't apply. I think the issue is, are there sufficient rules or regulations on the books under the law to handle the situation or whether it is appropriate to enact such rules or legislation.

Finally, Mr. Chairman, I would urge that after these hearings are completed—and I compliment you on the way they have been handled—that we continue the analysis of the futures markets through perhaps having economists here or people who understand the functioning of the markets who are not in the business, either as producers or as futures commission merchants or as broker dealers, and thus we have something to gain by no additional rule being promulgated to determine whether the current legislative or regulatory authorities are sufficient.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

Mr. Hance?

Mr. HANCE. I have no statement.

Mr. JONES of Tennessee. Mr. Coleman?

Mr. COLEMAN. I have no statement.

Mr. JONES of Tennessee. Mr. Marlenee?

Mr. MARLENEE. No statement.

Mr. JONES of Tennessee. Mr. Wampler, the ranking member of the full Committee on Agriculture and ex officio member of the subcommittee.

Mr. WAMPLER. I am delighted to be here, Mr. Chairman.

Mr. JONES of Tennessee. We are delighted you are here.

Our first witness is Mr. Daniel G. Amstutz, National Grain and Feed Association.

Mr. Amstutz, if you have someone accompanying you you would like to bring to the witness chair, you may do so.

STATEMENT OF DANIEL G. AMSTUTZ, NATIONAL GRAIN AND FEED ASSOCIATION

Mr. AMSTUTZ. Thank you, Mr. Chairman. Mr. Chairman and members of the subcommittee, my name is Daniel G. Amstutz. I am a general partner of Goldman, Sachs Co. I am chairman of the Commodity Exchange Committee of the National Grain and Feed Association on whose behalf I appear today to recommend changes in the Commodity Exchange Act.

We are concerned about the various proposals to apportion the jurisdiction of the Commodity Futures Trading Commission among other Government agencies and to have margins set by one or more Government agency. We strongly urge that none of these changes be made.

Unfortunately, futures markets are an enigma to many. Too few understand what futures markets are, how they function, and why.

Lack of knowledge about the margining concept of futures market is a graphic example of the misunderstanding of this institution.

Some seem to confuse margins on commodities with margins on securities. In order to provide better understanding of this matter, I would like to set forth the differences between margins on securities and margins on commodity futures contracts.

The purpose of margins in securities markets is clearly stated in the Securities and Exchange Act. It states:

For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Federal Reserve Board shall prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently registered on a national securities exchange.

Clearly, margin in this context refers to the required level of down payment on credit purchases of securities. In other words, the purchase of securities on margin is a credit transaction entailing transfer of the right to use and enjoy capital assets and also entailing the lending of funds.

In contrast, the purchase or sale of a futures contract on margin is not a credit transaction. In a futures transaction the contracting party has the right and obligation either to eventually choose to receive or deliver commodities or to enter into an offsetting transaction.

If the decision to actually receive or deliver is made, then the right to the capital asset—the commodity involved—is conveyed in a transaction requiring full and immediate cash payment. The only capital asset involved is the commodity itself, which can only be owned and used after delivery occurs, if it occurs, at which time ownership is financed through otherwise established credit facilities not under the purview of commodity exchanges, chiefly the banking system.

Since no title is conveyed prior to delivery, and no loan is expended, no credit can be involved in a futures transaction, hence the word "margin" has an entirely different meaning in this context, and the purpose of margin is different.

The purpose of margins in futures markets is to insure the financial integrity of all futures contracts trading on these exchanges. The purpose of margins in securities markets is to serve as a partial payment.

The function of securities markets is to transfer title from one owner of a security to another. The function of futures markets is not to transfer title, rather it is to transfer price risk. Recognition of the difference in function between these institutions should help in understanding the differences between them regarding margin concepts.

We do not believe any Government agency possesses the capability to manage the margin responsibilities for futures markets. We do not believe any Government agency could be sufficiently responsive to changes in margin levels that frequently must be effected in an environment of fast breaking inputs that necessitates rapid, immediately implemented decisions. Only the individual exchanges have the capability to deal with the logistical realities of margin setting responsibilities in our judgment.

We take no comfort whatsoever in the language of those legislative proposals that would exclude agricultural commodities from

Federal Government involvement in the establishment of futures market margins. We believe that governmental authority over margins in some commodities would eventually lead to governmental authority over margins in all commodities.

Some may believe that Federal Government authority over futures market margins may provide some sort of anti-inflation tool to Government. We contend that any who hold such a belief are, at best, misinformed. Government involvement in futures markets margins would be counterproductive to Government's desire to effectively battle inflation.

It must be clear to all that Federal Government control over futures market margins would result in higher initial margins than those established by the exchanges.

The fundamental purpose of margins on futures contracts would no longer be the protection of the financial integrity of these price discovery institutions. Rather, we fear Government would use margins to influence the ability of people to do business on futures exchanges and thus use margins to influence prices.

Margins established at levels higher than those necessary to maintain the financial integrity of the futures system will tend to raise the cost of marketing those commodities for which futures contracts exist. Thus, the objective of those that would raise margins in order to help fight inflation would not be met.

High margins increase the cost of hedging. There is an opportunity cost for margin money deposits. The higher the margin, the higher this opportunity cost. There is also an execution cost associated with commodity transactions. Execution cost is measured by the spread between the bid and ask prices and the size of that spread is directly related to the amount of participation in the market.

High margins result in reduced participation in the markets, wider spreads, and higher hedging costs. These higher hedging costs get passed back to producers in the form of lower prices or are forwarded to consumers in the form of higher prices.

Another major cost has to do with the disruption there could be to our marketing and distribution system. The marketing system that has evolved for agricultural products, and is evolving for other commodities trading on futures exchanges, is one that closely integrates the price discovery process of the futures markets into pricing in the cash markets.

If futures markets should become less liquid and hedging should become more expensive, it is likely that many of the institutional arrangements that have evolved and are evolving will be altered significantly. Many of the forward contracting devices that have been established by local grain elevators, for instance, might be discontinued or made less available to farmers and other small operators. The cost of marketing commodities so affected would increase accordingly. The overall cost to the economy could be enormous.

Higher hedging costs would, we think, impact negatively, particularly on smaller businesses. Smaller firms would find it much more difficult to compete simply because it would be too costly for them to use future markets as a means of effectively managing their risks.

Many of the forward contracting and forward pricing devices that currently exist in agriculture and that are being developed in other sectors exist only because the risks associated with those institutional arrangements can be laid off efficiently and at low cost through the commodity futures markets.

There are other costs to consider—costs Government would have to absorb to manage margin responsibilities on a myriad of futures contracts listed on the exchanges, costs that would be incurred if the regulatory authority for futures markets was divided among several agencies. Each of these costs would be substantial.

Considered collectively, it seems clear that even a cursory examination of the cost-benefits ratio must lead to the conclusion that any change in the Commodity Exchange Act would result in far higher overall costs and negligible, if not negative, benefits.

Thank you for considering this statement. I will be pleased to answer any questions you may have.

[The prepared statement of Mr. Amstutz may be found on p. 399.]

Mr. JONES of Tennessee. Thank you very much, Mr. Amstutz, for a very concise and sound statement.

I have one question that could be considered to be a series of two or three, and I am going to take my time first and have you answer it, and then I will defer to other members of the subcommittee.

In the statement you indicate that you are firmly opposed to Government set margins. What about speculative position limits on silver and other commodities which do not now have limits? And I ask you, hasn't our agriculture market functioned very well for many years with such speculative position limits?

Mr. AMSTUTZ. Yes, Mr. Chairman, they have. I think at the sake of poor memory, that one reason that had been advanced in the past for speculative position limits on certain commodities such as agriculture commodities and not for others had to do with the global nature of some commodities and not others. So the agricultural commodities for which limits had been established some years ago were deemed to be U.S.-produced commodities whereby commodities not under position limit guidelines were considered global commodities and/or considered in always abundant supply.

I think it is legitimate to address this question again in the context of all commodities and in the context of delivery technicalities that might make such consideration worthwhile.

Mr. JONES of Tennessee. Thank you very much, sir.

I yield back the balance of my time and yield to Mr. Harkin.

Mr. HARKIN. Thank you, Mr. Chairman. I only have one question, one that comes up periodically.

Would you comment on the feelings of some people that those who hold short positions in the market should be limited to those people who actually have the commodity itself?

Mr. AMSTUTZ. Would I hold to that?

Mr. HARKIN. Comment on that. Those that hold short positions should be only those that actually deal in that commodity.

Mr. AMSTUTZ. The magic of a price discovery mechanism that is truly working is one that is liquid, one where we have market fluidity. As the chairman said in his opening statement, speculators in free market institutions perform a very important economic

function. They are the other side to the hedging transaction, so to speak. They are willing to accept at least short-term risk.

To the extent there are bona fide hedging transactions both on the purchase side and on the sell side of any market, it is important for there to be speculative activity on either side of the market as well.

So I think the price that the economy would pay by limiting short-side speculation to only those who are entering in to offset hedges, so to speak, would be a loss of important fluidity and liquidity in the markets, and I think as a result of that we would have sharper price moves, more pronounced, and less stability than we enjoy by having full participation.

Mr. HARKIN. There are some who would argue the opposite, that while there might be sharp movement initially, they would begin to level out and you would have more long-term stability if this were the case; in other words, limiting those short sellers to those actually being in the commodity. It is an argument I hear all the time, and I just appreciate your comments on it.

Mr. AMSTUTZ. I understand. And I understand particularly some of the areas from which it comes. I have myself visited with cattle feeders, for example, who on occasion would contend that if only a person in the cattle business could be on the short side of the cattle market, that hopefully they would think perhaps cattle prices would be better.

Believe me, I have sympathy for their desires as to economic price for the product they are producing but I just don't think they are attacking the problem that really they are facing in the period of those low prices. They are having to live with a temporal situation where the supply is greater than demand.

Mr. HARKIN. Thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Harkin.

Now, Mr. Huckaby, do you have questions?

Mr. HUCKABY. Thank you, Mr. Chairman.

It has been suggested that perhaps there should be a limit, an absolute limit, on the degree of a position an individual, an entity, is allowed to take in any market, such as 10 percent. Would you comment on that? Would you be for it or against it? And let me point out I am talking about speculators, not legitimate hedges.

Mr. AMSTUTZ. I was first going to address it from a hedging standpoint and those kind of limits on hedging could create problems.

As I said in response to the chairman's question, I understand the history for why certain commodities were excluded from the position limit concept, and I think the reasons at the time those decisions were made were sound. I can see the merit in readdressing this particular question in the context of all commodities. I think it deserves a good deal of study. I don't want to give you today a sort of a hip-shot response that might be misleading. I believe it deserves study.

I will say, also—and perhaps you might regard this as off the point of your question, but to me it is part of it—I think part of the discussion these months sometimes gets symptom confused with the cause. The cause of so much that is happening in this country

has to do with inflation and inflationary fears and it is inflation and inflationary fears that perhaps need the correction rather than treating the symptoms.

And the inflation problem, as you know, Mr. Huckaby, relates partly to governmental policy and governmental action in the monetary and fiscal areas.

Mr. HUCKABY. This is true, but you may have the chicken and the egg backwards there. Which came first, the tens of thousands of people who were selling old silver, and all of a sudden it got much higher in value, feeding the inflation, not causing it. Which came first?

Don't you feel that something should be done to prevent what just happened in the silver market or should we let it happen again? There are other small entities of individuals or groups, many foreigners, that have more wealth at their disposal that could attempt to corner even the silver market again in the immediate future, either on the up side or the down side.

If you don't have any problems with this, just let me roll.

Mr. AMSTUTZ. I think partly what I am trying to say and certainly tried to say in the statement is that it is important to define that which is under the purview of the commodity exchanges and therefore under the purview of futures markets margins and those which are other questions.

For instance, to the extent that credit is extended for margin purposes, at any time, that is a question that relates to the lender area and not the commodity market area.

Questions that regard how collateral will be valued for purposes of credit are, under the current scheme of things in this country, business judgments by the banking industry. They can make a judgment as to the collateral value of almost any asset for loan purposes.

Should one attempt to legislate what their judgments should be as to collateral value on an asset owned and unhedged versus an asset owned and hedged, two different questions.

I don't know. I don't know whether it is possible to write legislation that could be truly enforced. I don't know whether the free market concepts in this country would survive with those kind of restrictions.

I think a lot of this has to do with judgments, judgments on values. I would guess some would rethink the question of collateral value today based on what has happened.

Mr. HUCKABY. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Huckaby.

Before I yield to Mr. Madigan for his questioning—I don't want to count this time—I am going to yield to him for the purpose of some introductions of some of our friends in the audience.

Mr. Fithian, a member of the full committee, just informed me that he and Mr. Madigan had breakfast with one of the gentlemen, and we would like to have them all introduced and invite them to take seats, if they would like to.

Mr. Madigan?

Mr. MADIGAN. There are in the audience, Mr. Chairman, several members of the German Bundestag, and as you said, Mr. Fithian and I had breakfast with them this morning. Is Herr Hess in the

audience now, I don't know whether he came in, but I think we should invite at least the gentlemen from the German Bundestag who have not been able to find a seat to come up here and sit. At least you will have a place to sit because when we visit you we certainly don't want to have to stand in the back of the room.

I would be happy to yield to Mr. Fithian.

Mr. FITHIAN. I would like to thank the gentleman for yielding.

Herr Roth is a member of the German Bundestag and represents a district north of the Black Forest. He has a unique interest in our hearings this morning in that he represents a very substantial constituency of jewelry workers and they had enormous problems as a result of the recent transactions in our silver market.

I want to extend my appreciation and welcome to Herr Roth at this time.

Mr. JONES of Tennessee. Thank you, Mr. Fithian and Mr. Madigan, and gentlemen, we would be very pleased if you would come take a seat by the clerk, if you would like to.

Mr. FITHIAN. I believe Herr Roth is the only one present from the delegation.

Mr. JONES of Tennessee. It is very appropriate he is here today at the hearings we are conducting, and we are glad you are here.

I yield to Mr. Madigan for the purpose of his asking questions.

Mr. MADIGAN. Thank you, Mr. Chairman.

Mr. Amstutz, Goldman, Sachs & Co., do they trade in silver?

Mr. AMSTUTZ. Yes, we have traded in silver.

Mr. MADIGAN. Are you a trader on the New York Commodity Exchange yourself?

Mr. AMSTUTZ. I am a member of the Commodity Exchange, Inc. in New York and other commodity futures exchanges. I don't trade on the floor of any exchange.

Mr. MADIGAN. Your firm does trade on the floor?

Mr. AMSTUTZ. Yes, we are a member firm of the principal commodity exchanges.

Mr. MADIGAN. And does trade in silver?

Mr. AMSTUTZ. Yes.

Mr. MADIGAN. For yourself and for others?

Mr. AMSTUTZ. Yes.

Mr. MADIGAN. Was the Hunt position widely known before the price of silver tumbled so dramatically?

Mr. AMSTUTZ. Yes, it was known that there were major speculative positions on the long side.

Mr. MADIGAN. Was it generally known those positions were held by the Hunt brothers?

Mr. AMSTUTZ. It was rumored that they were one of the substantial longs, yes.

Mr. MADIGAN. What kind of time period elapsed from the point where you would say that the Hunt position was widely known until the market began to tumble?

Mr. AMSTUTZ. It seems to me, Mr. Madigan, as I try to think back, that talk of discussion of these long speculative positions began in October 1979.

Mr. MADIGAN. So a period of several months passed from the time that the Hunt position generally was known until the price of silver began the rapid decline?

Mr. AMSTUTZ. Yes. If I might say, sir, also from the time it was generally known until the price dropped there was quite a bulge in price. As it became generally known in October, or talked about, prices moved quite sharply up from that point before they dropped.

Mr. MADIGAN. Would it be fair to say that the dramatic decline in the price of silver was a result of the new or different regulations imposed by the exchanges in New York and Chicago?

Mr. AMSTUTZ. It is a very good question, and these chicken-egg questions are difficult. Certainly the various rules, regulations and enforcement type proceedings promulgated by the exchanges had to do with desires to urge liquidation of long positions and the raising of margin rates and so forth certainly contributed to the decline.

Mr. MADIGAN. In your statement on the bottom of page 3 when you talk about "marked-to-the-market" at the end of the day, your statement says, "The profits and losses are always exactly equal."

Does that mean that if the Hunt's lost \$800 million, other people made \$800 million?

Mr. AMSTUTZ. Yes, literally it does. I always hate to use this term because it is somehow a buzz term, but commodity futures markets are a zero sum enterprise and the marketplace itself is not profiting or losing.

The whole concept of the open auction environment of it, if you and I were together on the exchange floor and each of us wanted to transact business, we would have to find in that auction process somebody to buy from us or sell to us, and so each time I sell, someone else has to buy, and vice-versa.

It could be misleading from the conclusion if somebody lost x amount of money, does somebody else make it. To the extent there is hedging involved in these markets, and the axiom says no market can long survive unless there is strong hedging use of it, then the cash offset gains or losses are not reflected in the futures gains or losses. You have to put them together to come up with a figure.

Mr. MADIGAN. My time has expired. Thank you, Mr. Amstutz. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Madigan. Now to Mr. Glickman for 5 minutes of questioning.

Mr. GLICKMAN. Thank you.

Mr. Amstutz, I am a bit confused about what I perceive to be is a bit legalistic definition of the difference between margins on security and margins on the futures.

I realize and I understand the differences that you are talking about, but it strikes me that the last 10 or 15 years of the futures markets may have actually changed the functional purpose of margins a bit because you have seen an enormous increase in the public interest in the investments in futures. And you are in the brokerage business and I am sure if you took an aggregate percentage of income made by broker dealers on futures commissions vis-a-vis securities commissions and you look at your customers who are in and out, you will see an enormous increase of public interest.

What I would like to ask you is, do you acknowledge that and do you also acknowledge that one of the byproducts of margins is to discourage speculation?

Mr. AMSTUTZ. No question. The higher the margins, the more the speculation is discouraged.

I acknowledge also and express at the same time my frustration over this misunderstanding about what futures markets are. I frequently have people coming to me saying, and using the very words you used, I would like to invest in the futures market.

My answer always is, futures markets are not an investment. If you want to invest in commodities, let's go out and find some bullion or whatever.

Investors use futures markets as a tool, but futures contracts, futures transactions, are not investments.

Mr. GLICKMAN. You may be a very responsible individual. My only point is, to large numbers of the public they view the futures market as the only appropriate way to invest in commodities to protect against inflation.

I am saying there has been enormous change in the economies associated with both investments in the future markets, and I am saying perhaps the classic legalistic distinctions of margins on securities and margins on futures may be less significant or appropriate then they were 20 or 25 years ago. I am saying that is something this committee has to explore.

Mr. AMSTUTZ. I understand.

Mr. GLICKMAN. The other thing I would point out is your statement, "We do not believe any Government agency has the capacity to be involved in margins."

I went back and looked at the authorizing legislation of the Securities Exchange Act of 1934 and the legislation giving the Federal authority to set margins on securities, and that exact statement was said by opponents to margins.

My only point is that all these things are fluid, and I would hope that people in the industry as well as people on our side take what I consider to be an objective, responsible view toward the economies of futures markets themselves.

Mr. AMSTUTZ. Understood.

Mr. Glickman, the one major point I would like to say in response is, with the down payment concept in securities, sort of a percentage margining concept is possible on stocks. For example. I brought with me—this is a computer run of the daily margins for each commodity. Each commodity has to be considered separately. It is not just a percentage calculation. This is an enormous task of deciding what these margin levels should be each day. It is not the question of picking a percentage.

Mr. GLICKMAN. Right. I have introduced legislation giving the CFTC standby authority to set margins. What is your position on that legislation?

Mr. AMSTUTZ. My interpretation of the act as it is currently written is that included in the CFTC's emergency powers is that power and it seems to me that even though there has been a tendency to test these things in court, that the strong emergency powers of the CFTC have been tested in court, and I am satisfied that in the language of the current law—

Mr. GLICKMAN. Mine is theoretically designed to prevent emergencies from occurring in the first place. They do have emergency

powers, but if they can be used at all, they can be used only once the emergency has occurred. That is basically the difference.

I thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

Mr. HANCE, do you have any questions?

Mr. HANCE. One.

In each futures contract you have to have two sides and somebody goes long and somebody short and vice-versa. The one thing I would like you to touch on briefly, with the prices going up the Hunts had a lot to gain, but with the prices going down, you know, whoever was on the other side of those contracts had a lot to gain. Certainly there was no one person on the other side of those contracts, but in your industry, what is the word, who were the substantial people on the other side of the contract?

Mr. AMSTUTZ. Who were the shorts?

Mr. HANCE. Right.

Mr. AMSTUTZ. I hate axiomatic statements because they tend to be broad generalizations, and generalizations are sometimes misleading, but the short side of the market is always deemed to be the inventory hedging side. So whomever is carrying inventory of whatever the commodity is, the industry owning cash commodities on one side, the shorts, the futures on the other, so the hedgers.

Mr. HANCE. Would any of the investment firms that trade in commodities, would any of those firms be people that you would list as people that were hedging and that were short?

Mr. AMSTUTZ. Yes, some of them could have been.

Mr. HANCE. Would you say it would be a substantial amount percentage-wise of the people on the other side of the contract?

Mr. AMSTUTZ. I honestly don't know the answer to the question so all I could do would be to guess. My guess would be that in the CFTC, records would show this, that the larger short side positions were the industrial merchants.

Mr. HANCE. Thank you very much. I call back the balance of my time.

Mr. MARLENEE. Would the gentleman yield?

Mr. HANCE. Yes.

Mr. MARLENEE. Wasn't Armand Hammer on the short side?

Mr. AMSTUTZ. As you asked the question, I recall reading a newspaper article, and that is my only knowledge, some months ago.

Mr. MARLENEE. Didn't that article state that on the short side Occidental Petroleum or Armand Hammer stood to gain about \$200 million?

Mr. AMSTUTZ. I honestly forget, sir. I recall the article, I forget the amount, and I don't know whether it is true or not.

Mr. MARLENEE. I thank the gentleman for yielding.

Mr. HANCE. I yield back the balance of my time, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much.

Mr. Coleman?

Mr. COLEMAN. I have no questions.

Mr. JONES of Tennessee. Mr. Baldus?

Mr. BALDUS. I yield.

Mr. JONES of Tennessee. Mr. Bedell?

Mr. BEDELL. Just a short question.

Are Goldman, Sachs & Co. involved in elevators or the sale of grain or this sort of thing, Mr. Amstutz?

Mr. AMSTUTZ. Not in the cash side of the grain business. We are involved in the grain business as a futures commission merchant serving hedging clients in the futures market.

Mr. BEDELL. It says: "Included in its members are country and terminal elevators, merchandisers, processors and exporters covering the wide spectrum of the grain and feed industry."

How does Goldman, Sachs fit into that?

Mr. AMSTUTZ. Also included in the membership are brokerage firms. And let me just anticipate a question: Why am I chairman of this committee for the association? For most of my working career I was involved in the grain business.

Mr. BEDELL. In what capacity and with whom?

Mr. AMSTUTZ. With the Cargill organization and in a number of capacities for some 25 years in grain merchandising activities.

Mr. BEDELL. But Goldman, Sachs has been a member of the organization for a long time?

Mr. AMSTUTZ. Goldman, Sachs has been a member of the association since I have joined Goldman, Sachs.

Mr. BEDELL. I call back the balance of my time.

Mr. JONES of Tennessee. Thank you, Mr. Bedell.

Mr. Marlenee?

Mr. MARLENEE. I would like to yield my time to Mr. Madigan.

Mr. MADIGAN. I appreciate the gentleman yielding, and I do have some other questions, Mr. Chairman, I would like to ask of this witness. But I think that I will provide those questions for the record because I understand that you want to move ahead and get the other witnesses in here. I do thank the gentleman for yielding.

Mr. JONES of Tennessee. Thank you, Mr. Marlenee, and Mr. Madigan.

Mr. Daschle?

Mr. DASCHLE. Mr. Chairman, I have no questions.

Mr. JONES of Tennessee. Mr. Hopkins?

Mr. HOPKINS. No questions, Mr. Chairman. Thank you.

Mr. JONES of Tennessee. Now, we have gathered an additional member of the full committee or two, and I don't want to be unfair, I just want to insist that we stay on time as much as we can.

Mr. Fithian, do you have any questions you would like to ask?

Mr. Symms?

Mr. Johnson?

We are delighted all of you are here.

Mr. Wampler?

Mr. WAMPLER. No questions.

Mr. JONES of Tennessee. Thank you, gentlemen, for being here.

Mr. Madigan, do you want to submit your questions or would you rather ask them?

Mr. MADIGAN. I understand from the staff that the other witnesses are ready and we can bring them in.

Mr. JONES of Tennessee. Does any other member have a short question?

Thank you very much, Mr. Amstutz, for your answering the questions and also the statement that you made.

Mr. AMSTUTZ. Thank you, Mr. Chairman.

[The prepared statement of Mr. Amstutz follows:]



**NATIONAL
GRAIN & FEED
ASSOCIATION**

Statement of
The National Grain and Feed Association
Before the
Subcommittee on Conservation and Credit
Committee on Agriculture
U.S. House of Representatives
On Possible Need for Amendments to the
Commodity Exchange Act

By
Daniel G. Amstutz
May 29, 1980

Mr. Chairman and Members of the Subcommittee:

My name is Daniel G. Amstutz. I am a general partner of Goldman, Sachs & Co., New York, New York. I am the Chairman of the Commodity Exchange Committee of the National Grain and Feed Association on whose behalf I appear today.

The National Grain and Feed Association is a voluntary association of grain and feed firms, independents and cooperatives, ranging in size from the smallest country elevators to the largest grain and feed complex. Included in its members are country and terminal elevators, merchandisers, processors and exporters covering the wide spectrum of the grain and feed industry. Our membership is comprised of 1200 companies and 46 state and regional grain and feed associations that include upwards of 10,000 grain and feed companies nationwide.

Our members rely heavily upon futures markets to hedge their purchases and sales of agricultural commodities and other commodities thereby reducing their business risks to the benefit of producers (farmers) and consumers. The continuous price discovery mechanism of the futures markets permits our members to offer a fair price to producers and consumers alike. It is for these reasons that we appear today to recommend no changes in the Commodity Exchange Act.

We are concerned about the various proposals to apportion the jurisdiction of the Commodity Futures Trading Commission among other government agencies and to have margins set by one or more government agency. We strongly urge that none of these changes be made.

It appears that one of the principle, continuing problems of futures markets is that they are an enigma to many. Too few understand what futures markets are, how they function, and why. Lack of knowledge about the margining concept of futures markets is a graphic example of the misunderstanding of this institution. Some seem to confuse margins on commodity futures with margins on securities. In order to provide better understanding of this matter, I would like to set forth the differences between margins on securities and margins on commodity futures contracts.

The purpose of margins in securities markets is clearly stated in the Securities and Exchange Act of 1934 under the heading "Margin Requirements": "For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Federal Reserve Board shall prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently registered on a national securities exchange." Clearly, margin in this context refers to the required level of down payment on credit purchases of securities. In other words, the purchase of securities on margin is a credit transaction, entailing transfer of the right to use and enjoy capital assets--e.g., common stocks--and also entailing the lending of funds.

In contrast, the purchase or sale of a futures contract on margin is not a credit transaction. A futures transaction entitles the contracting party the right to eventually choose to receive or deliver commodities. If the decision to actually receive or deliver is made, then the right to the capital asset--the commodity involved--is conveyed in a transaction requiring full and immediate cash payment. The only capital asset involved is the commodity itself, which can only be owned and used after delivery occurs, if it occurs, at which time ownership is financed through otherwise established credit facilities not under the purview of commodity exchanges, chiefly the banking system. Since no title is conveyed prior to delivery and no loan is extended, no credit can be involved in a futures transaction, hence the word "margin" has an entirely different meaning in this context, and the purpose of margin is different.

When one enters into a futures transaction (either as a buyer or a seller), he must deposit a specified minimum amount of money required by the exchange on which the commodity is traded. This deposit is called "initial" or "original" margin. The initial margin on futures transactions is a performance bond, not a down payment. It is established at a level intended to cover short term price change. It varies in amount depending on the price volatility of each commodity.

Each day the long (purchase) and short (sale) transactions carried with each exchange clearinghouse are "marked-to-the-market". This daily marking-to-the-market results in "variation" margins, funds paid to the exchanges by those whose positions show losses relative to any day's settlement prices and credited to those whose positions show profits relative to that day's settlement prices. This daily process of marking-to-the-market assures the continually current transfer of funds from those who incur losses to those who profit from futures price movements. The profits and losses are always exactly equal. Unlike

securities markets there is a short (sale) position opposite every long (purchase) position in futures markets; each sale of a futures contract is exactly symmetrical with the purchase of a futures contract and vice versa.

The purpose of initial and variation margins in futures markets is to insure the financial integrity of all futures contracts trading on these exchanges. The purpose of margins in securities markets is to serve as a down payment. The function of securities markets is to transfer title, from one owner of a security to another. The function of futures markets is not to transfer title, rather it is to transfer price risk. Recognition of the difference in function between these institutions should help in understanding the differences between them regarding margin concepts.

We do not believe any government agency, no matter how enlightened or well-intentioned, possesses the capability to manage the margin responsibilities for futures markets. We do not believe any government agency could be sufficiently responsive to changes in margin levels that frequently must be effected in an environment of fast breaking inputs that necessitates rapid, immediately implemented, decisions. Only the individual exchanges have the capability to deal with the logistical realities of margin setting responsibilities in our judgement.

We take no comfort whatsoever in the language of those legislative proposals that would exclude agricultural commodities from Federal Government involvement in the establishment of futures market margins. We believe that governmental authority over margins in some commodities would eventually lead to governmental authority over margins in all commodities. To document the validity of this fear we point to the language of one of the legislative proposals. It states that a government agency would have margin authority for any commodity which the Board of Governors of the Federal Reserve System determines has monetary

characteristics or is a store of value. Many would contend that all commodities have monetary or store of value characteristics and, to a certain extent, all do. Notwithstanding the fundamental differences between the margining concept for futures markets and that for securities markets, some in Congress may believe that Federal Government authority over futures market margins may provide some sort of an anti-inflation tool to government. We contend that any who hold such a belief are, at best, misinformed. We contend that government involvement in futures markets margining would be counter-productive to government's desire to effectively battle inflation.

It must be clear to all that Federal Government control over futures market margins would result in higher initial margins than those established by the exchanges. The fundamental purpose of margins on futures contracts would no longer be the protection of the financial integrity of these price discovery institutions. Rather, we fear government would use margins to influence the ability of people to do business on futures exchanges and thus use margins to influence prices.

Margins established at levels higher than those necessary to maintain the financial integrity of the futures system will tend to raise the costs of marketing those commodities for which futures contracts exist. Thus the objective of those that would raise margins in order to help fight inflation would not be met.

High margins increase the cost of hedging. There is an opportunity cost for margin money deposits. The higher the margin, the higher this opportunity cost. There is also an execution cost associated with commodity transactions. Execution cost is measured by the spread between the bid and ask prices and the size of that spread is directly related to the amount of participation in the market. High margins result in reduced participation in the markets, wider spreads, and higher hedging costs. These higher hedging costs get passed back to producers and suppliers in the form of lower prices or are forwarded to consumers in the form of higher prices.

Another major cost that would result from a change in the margining concept has to do with the disruption there could be to our marketing and distribution system. The marketing system that has evolved for agricultural products, and is evolving for other commodities trading on futures exchanges, is one that closely integrates the price discovery process of the futures markets into pricing in the cash markets. If futures markets should become less liquid and hedging should become more expensive, it is likely that many of the institutional arrangements that have evolved and are evolving will be altered significantly. Many of the forward contracting devices that have been established by local grain elevators, for instance, might be discontinued or made less available to farmers and other small operators. The cost of marketing commodities so effected would increase accordingly. The overall cost to the economy could be enormous.

Higher hedging costs and the deleterious effect this could have on the economy as a result of Congress granting margin setting authority to a government agency would, we think, impact negatively particularly on smaller businesses. Smaller firms would find it much more difficult to compete simply because it would be too costly for them to use futures markets as a means of effectively managing their risks. Many of the forward contracting and forward pricing devices that currently exist in agriculture, and that are being developed in other sectors, exist only because the risks associated with those institutional arrangements can be laid off efficiently and at low cost through the commodity futures markets.

There are other costs to consider--costs government would have to absorb to manage margin responsibilities on a myriad of futures contracts listed on the exchanges; costs that would be incurred if the regulatory authority for futures markets was divided among several agencies. Each of these areas of cost would be substantial. Considered collectively, it seems clear that even a cursory examination of the cost/benefits ratio must lead to the conclusion that any change in the Commodity Exchange Act would result in far higher overall costs and negligible if not negative benefits.

Thank you for your consideration of this statement. I will be pleased to answer any questions you may have.

Mr. JONES of Tennessee. Now we will call the other witnesses. I understand there are two and there may be others with them. Mr. Nelson Bunker Hunt and Mr. W. Herbert Hunt of Dallas, Tex.

Welcome, gentlemen, to the witness chair, and whoever is with you, Mr. Nelson Bunker Hunt and Mr. Herbert Hunt, you may seat them at the witness table also.

Gentlemen, we have to proceed and I would ask the press to take their respective positions.

Mr. Nelson Hunt and Mr. Herbert Hunt, we are delighted you are here. We appreciate the fact that you have appeared before our subcommittee that has the jurisdiction over commodity exchanges and trading here on the House side of the Department of Agriculture and the Committee on Agriculture. I see you have two gentlemen with you.

We have your statement in front of us. I presume that Mr. Herbert Hunt is going to read the statement. Is that correct?

STATEMENT OF NELSON BUNKER HUNT, ACCOMPANIED BY NORMAN J. BARRY; AND W. HERBERT HUNT, ACCOMPANIED BY ROGER GOLDBERG

Mr. HERBERT HUNT. I would be glad to, Mr. Chairman.

Mr. JONES of Tennessee. Whichever one would like to may do so. I believe you understand the rules that we are going by and when the red light appears your time is up. You have 10 minutes.

Mr. HERBERT HUNT. It is not that long a statement.

I am W. H. Hunt. I live in Dallas, Tex., and I welcome the opportunity that this committee has given me to express my views of the recent rise and fall in silver prices.

My analysis of the recent economic history of the United States has led me to believe that the wisest investment is one which is protected from inflation. In my opinion, natural resources meet this criterion, and to that end, I have invested in oil, gas, coal, precious metals, including silver, precious natural resources.

I first became interested in silver as an investment and not as a speculation in 1973. I began purchasing silver futures contracts and silver bullion. At that time, New York spot prices for silver averaged about \$2.55 per ounce. Again, I wish to emphasize that I consider myself an investor, not a speculator, in silver.

Throughout the seventies I purchased and sold silver bullion and held positions in silver futures contracts on the Commodity Exchange in New York which is commonly known as Comex, and on the Chicago Board of Trade which is known as the CBOT.

During that time, I stood for delivery on some contracts, but generally I continued to roll my futures positions forward and on those occasions when I did take delivery, I am unaware of any market disruption caused by my activities in the market.

In early 1979, I became convinced that the economy of the United States was in a weakening condition. This reinforced my belief that investment in precious metals was wise, and because of the rampant inflation, the value of soft currency was in jeopardy. I did invest substantially in silver futures contracts, but generally such purchases were completed before July 1979, when silver was selling for approximately \$8.50 per ounce. Well after I established

such positions, the price of silver on the two major exchanges, Comex and CBOT, rose to in excess of \$40 per ounce in early 1980.

In early September, when spot silver was trading in the \$11 to \$12 range, the exchanges began taking the action which in my view was designed to drive the price of silver down by depriving investors of access to the market and creating market illiquidity.

In early September 1979, the CBOT increased the margin for new silver futures contracts from \$1,500 to \$2,500. Similarly, the Comex at about the same time raised the original margin requirement from \$2,000 to \$3,000. During the 2 weeks following the initial increases, the exchanges raised the initial margin requirement to at least \$20,000 per contract.

These increased margin requirements were initially applied to only new contracts, but later, at least on the Comex, retroactive margin requirements were imposed which required a payment as high as \$75,000 per contract.

Throughout the fall of 1979, the price of silver continued to rise despite the increasingly higher margin requirements imposed by the exchanges. The exchanges then imposed position limits. On October 25, 1979, the CBOT declared a 600-contract limit on new futures positions and initially required reduction to the new limit in each contract month by February 1, 1980, by those who held contracts in excess of the 600 limit. The February deadline was later extended to April 1, 1980.

Not to be outdone, the Comex, on January 7, 1980, declared that as of February 8, 1980, a 2,000 gross contract position would be imposed. In addition, the Comex was to require a reduction of at least 10 percent per month in all positions which exceeded this 2,000-contract limit.

In my view, the effect of these higher margin and position limit requirements was as follows: First, access to the silver futures market by the average investor or speculator was denied by the high margin requirements. The result: there were no small buyers. Second, the position limits required large traders to dispose of their contracts. The natural result of these artificial factors was to drive the price of silver down.

Mine was the distressful economic situation of being compelled to be a seller without buyers.

The exchanges finally broke the silver market on January 21 and 22, 1980. On January 21, the Comex limited trading to liquidation only. On January 22, the CBOT limited trading in January, February and March silver futures to liquidation only. The effect of these actions was to drive the price down by making the market completely illiquid. The price of silver never again attained the levels of January 21 and 22. A comparison of the number of existing contracts, or "open interest," on the Comex and CBOT, for the period September 28 through February 1 illustrates my point, that the market had become illiquid. Between September 28, 1979, and February 1, 1980, the number of outstanding contracts on the Comex dropped approximately 53 percent and more than 69 percent on the CBOT.

The price of silver continued to decline until late March 1980. I believe that this decline was the inevitable result of the regulatory actions taken by the exchanges.

The reason given by the exchange for these dramatic changes in the rules, and in my opinion, manipulation actions, was that there existed an emergency in the market; namely, that there was a lack of silver for delivery brought about by the presumption that those holding futures positions would stand for delivery. I submit that this was not the real reason.

The members of the board of directors, at least of Comex, were engaged in or represented firms engaged in trading. Did some members of the board have an interest in forcing the market price of silver down? It has been reported that there were members of the Comex board who had a vested interest in seeing that the price of silver went down. These were representatives or employees of major precious metal dealers or floor brokers who had acquired short positions as the price went up. Was there a conflict of interest that existed with respect to board members and their firms? Other pertinent questions are:

One, were their actions between September 1979 and February 1980 "market neutral" or were they designed to drive the price of silver down?

Two, did the board members or their firms profit from the market?

Three, did their regulatory actions make this possible?

Four, who had access to position reports and was this information leaked to nonauthorized persons and firms in the market? One investor reported gains in excess of \$1 million.

Five, have the board members engaged in market manipulation in concert or individually for themselves and their firms?

During this period of time, I had several contacts with representatives of both the CBOT and Comex. Our discussions were frank and open. In each instance, I expressed my view that the actions taken by the exchanges were not fair or market neutral. I confirmed my belief in liquid markets and that I would do whatever was necessary to relieve market congestion. In addition, from time to time, I made commitments with regard to my personal trading and agreed to roll positions forward. I fulfilled my commitments on each occasion with one exception, when it became impossible to do so.

Finally, from time to time, I was in contact with members of the Commodity Futures Trading Commission (CFTC) or its staff. Again, I communicated my views with regard to the market. Additionally, any report required by the CFTC or request of information made of me by the CFTC was complied with.

I would be pleased to respond to your questions. Thank you for inviting me to participate in your hearings.

Mr. JONES of Tennessee. Thank you very much, Mr. Herbert Hunt.

Mr. Nelson Hunt, do you have any statement that you want to make?

Mr. NELSON HUNT. No, I don't. I will just adopt this statement. I think you have had a classic case of market manipulation by the shorts who run the board of governors of both the Chicago Board of Trade and the Comex in New York, and for self-serving reasons, and the number of shorts is a fairly small number compared to the thousands of longs, so you had a handful of people doing a self-

serving operation at the expense of the thousands of normal—and the public is generally the longs. The professionals are shorts. It was that kind of a situation.

Mr. JONES of Tennessee. Thank you, Mr. Nelson Hunt.

Gentlemen, I will take my 5 minutes first as chairman of the subcommittee, and ask my question, and get down as far as I can. As I said in the beginning, if we want to go to the second round, we will do so.

Mr. Herbert Hunt, the vast wealth of the Hunt family and the family's enthusiastic embrace of the free market philosophy are well known. What I would like to know from each of you is, do you have any commitments to markets which are free of manipulations, squeezes, and corners?

Mr. HERBERT HUNT. Mr. Chairman, I think you are asking do I have any commitments to markets?

Mr. JONES of Tennessee. Yes, sir, do you have any commitments which are free of manipulations or squeezes and corners?

Mr. HERBERT HUNT. Yes. I am involved in many different businesses, and I very frankly am not interested in getting in markets that are subject to freezes, squeezes, and manipulation.

Mr. JONES of Tennessee. Do you believe that your involvement in the silver market, both cash and futures for the past several years, influenced in any way silver prices which skyrocketed in 1979 and early 1980, and then fell abruptly to about \$10?

Mr. HERBERT HUNT. I believe that silver prices are going up regardless of who is in the market or what they are doing, because it is a matter of supply and demand, and the cost of that supply. Now mining costs are rising. It is costing more and more to mine silver. I am told that, off course, every silver mine has a different cost depending on the grade of silver that it is mining, and how deep they are bringing it from, and many other factors.

But I think if you would look at the industry as a whole, and you had to go out and put in a new mine, you would be talking about \$20-plus an ounce silver, and therefore I think that silver prices are going to rise regardless of whether I buy silver or you buy silver. I don't think that makes any difference. So, in answer to your question, I don't feel that the fact that I bought silver necessarily caused the price of silver to go up.

Mr. JONES of Tennessee. In other words, what you are saying is that your involvement in the market had nothing to do with the change in prices; that is your opinion?

Mr. HERBERT HUNT. That is my opinion. Of course, any time somebody wants to buy something, why, the price goes up, whether it is a house or what, because as long as you have somebody that wants to be a buyer, why, there is a demand for it.

Mr. JONES of Tennessee. My final question is, I am aware at this point of two critical market situations in which you are involved, the recent silver market and the 1974 soybean futures market. Both seem to be influenced by your being willing to use your wealth in ways which may not be illegal, but which are obviously disruptive to our economy and costly to market users.

Additionally, these incidents result in a loss of faith and confidence in our markets. Now, considering these circumstances, do

you see any reason the Government should not take action that is designed to prevent such incidents in the future?

Mr. HERBERT HUNT. Mr. Chairman, I don't agree with the fore-runner of your question. Literally, I think free markets are the markets that are best for the economy. You mentioned soybeans, or an incident which I assume you are referring to soybeans in which I was a buyer of soybean actuals and soybean futures, and the price did go up because there was a shortage of soybeans. In that case again, the market, I feel, had restrictions placed on it that caused the market to go down.

The real losers in that case were the hundreds of thousands of farmers that lost the opportunity to get higher prices for their soybeans due to the fact that the market, through unnatural forces, was forced to go back down.

Mr. JONES of Tennessee. Thank you very much, Mr. Herbert Hunt, and now I yield 5 minutes to Mr. Harkin.

Mr. HARKIN. Thank you, Mr. Chairman.

Mr. Hunt, in your testimony before us today and in your testimony before a previous subcommittee of the House, you made what I consider to be very serious allegations of misconduct by the boards. For example, on page 2 you state in your written testimony that the exchanges, the CBOT Exchange and the Chicago Board "In early September began taking action which in my view was designed to drive the price of silver down." That is a pretty serious allegation.

Further on in your statement you say that the exchanges, "Finally broke the silver market on January 21 and January 22." Now, the boards have given their reasons for doing that, and to use their written testimony, the Comex have stated that during this period in question, that is, from about September through January, a series of actions were taken, No. 1, to avoid the possibility of any manipulation, squeeze, or corner in the silver market.

Two, to continue the viability of the silver futures market.

Three, to insure the continuing financial integrity of the market-place through increased margin requirements.

I will skip the other ones but: Six, to curb potentially excessive speculation in the silver market.

On the one hand we have the exchanges saying that they were taking actions to protect the public. On the other hand, you are saying that the exchanges were taking actions which in fact broke the Hunts. Are both of those correct statements or is one of those statements erroneous?

Mr. HERBERT HUNT. Well, I think that the exchanges when they take actions, those actions should be what is known as market neutral. They should be not to make the price go up or to make the price go down. That is not their function, and the actions that they took were such that they made the market completely illiquid, and then put restrictions on it that people had to sell, and that literally fixed the market where there could—pardon me, where they had to sell and literally put the market in such shape where there was no possibility to be buyers, and when you rig a market in that way, it can't go any way but down. And so I have to say that while they talk about concern of corner, et cetera, that was not the real reason that these actions took place.

Mr. HARKIN. Mr. Hunt, Comex has stated that they were concerned that the availability, deliverable supply of silver was to a great extent controlled by the Hunt group and foreign investors. In other words, what they are saying is that the Hunts were cornering the market in silver, and that they were trying to protect the hundreds and thousands of other investors in silver from having this happen.

Were you trying to corner the market in silver?

Mr. HERBERT HUNT. Mr. Harkin, I was not trying to corner the market in silver, and I know that the exchanges were stating that that was the reason. But the facts are I met with the exchanges and said I was willing to roll my positions forward and not take delivery on what positions I had.

Mr. HARKIN. I understand. Yes, you are saying you were willing to roll them over.

Mr. HERBERT HUNT. Move them forward.

Mr. HARKIN. I understand that, but the Comex has said, though, that they were concerned that the Hunt group and foreign investors were acquiring silver through the London silver market, and deliveries made on the Comex of physical silver in December 1979 by the Hunt group reflected a continuing desire of the Hunt group and foreign investors to obtain supplies of silver potentially in excess of those available through licensed depositories.

Again, they are stating quite clearly, quite concisely, quite irrevocably, that you were in the position of cornering the market on silver, not only in this country but abroad.

Mr. HERBERT HUNT. I know that is what the exchanges are saying, Mr. Harkin, but if you will look on the report that the CFTC prepared for the Committee on Agriculture, Nutrition, and Forestry, you will see that it states:

However, neither the Commission's surveillance staff nor the exchanges determined that any such connection existed based on the information available at that time. The Commission surveillance staff intensified its inquiry into the possible relationship between the Conti and Hunt accounts and attempted to determine the extent to which these accounts owned the deliverable supply of silver.

Then it went on to say that there was no connection, and someplace else in their report, the CFTC report states that there was no corner of the market. I don't know exactly where it is, but I do remember reading it in there.

Mr. HARKIN. I see that my time is up. I do have a couple more questions about your position in terms of whether the Government ought to be stronger in the CFTC in regulation. We have these two quite divergent positions between a very powerful investor and a very powerful exchange. Perhaps the Government should have more regulatory power. I want to ask you that question later.

Mr. JONES of Tennessee. Thank you. I yield 5 minutes to Mr. Madigan, the ranking member of the subcommittee.

Mr. HERBERT HUNT. If I could, my counsel here found the statement I was trying to find, and I read: "Commission did not have reason to believe that a threat of manipulation in the silver futures market existed which would justify emergency action by the Commission."

Mr. MADIGAN. Mr. Hunt, Herbert Hunt, newspapers have indicated that you and your brother borrowed about \$1 billion in direct and indirect loans, and I am not talking about the recent loan. I

am talking about prior to that, that you and your brother had borrowed about \$1 billion for speculation purposes from 12 banks in the United States, and four American branches of foreign banks. Are those stories accurate?

Mr. HERBERT HUNT. Mr. Madigan, as I stated earlier, my positions were essentially mostly acquired before July of last year, and as the price went up, I essentially was not a borrower. Now, I always have some kind of financing, so there is always rolling it over or refinancing, this sort of thing. When I became a borrower was when the price of silver came down, and I was called upon for matching money.

Mr. MADIGAN. When is that? What time frame are we talking about?

Mr. HERBERT HUNT. That was essentially late January, February, March. Now, you mentioned numbers of banks and this sort of thing. The financing that I did in conjunction with the silver which I owned was done with brokerage houses, and some was done with a Swiss bank corporation. Now, I am sure that the brokerage houses had financing with their banks, but I know nothing about it, don't know who they are, and this sort of thing.

Mr. MADIGAN. That money that you were borrowing as the silver price was coming down, well, without regard to which banks it was, they were U.S. banks that were loaning you money as the silver price was coming down; is that correct?

Mr. HERBERT HUNT. I don't know.

Mr. MADIGAN. You don't know who was loaning you money?

Mr. HERBERT HUNT. No, I do not. I know I was borrowing money from brokerage firms that were in the commodity business and have a normal practice of making inventory financing-type loans.

Mr. MADIGAN. You were not borrowing money directly from banks?

Mr. HERBERT HUNT. I was not, except with the exception of the Swiss bank corporation.

Mr. MADIGAN. There were brokerage houses that would loan you upwards of \$1 billion?

Mr. HERBERT HUNT. No, I didn't borrow that much money, Mr. Madigan. I don't know the specific amounts, because I personally don't handle those arrangements. I have financial people who arrange to finance my positions.

Mr. MADIGAN. Do you know how much silver you presently own? I am talking about physically own, not necessarily contracts for future delivery, but how much silver you presently own, either in deposit in the United States or in some other country?

Mr. HERBERT HUNT. I don't have that figure with me today, but I will be glad to get it for you and furnish it to you, Mr. Madigan.

Mr. MADIGAN. Could you estimate how much that would be?

Mr. HERBERT HUNT. I am not sure I can, because you see, much of the positions I had were liquidated by the brokerage houses when I failed to make their calls for additional funds, and I am still in the process of having auditors audit this, and I don't have the up-to-date figure but I think it can be gotten for you, and I will be glad to do it.

Mr. MADIGAN. I appreciate it being submitted for the record.

Mr. HERBERT HUNT. Fine.

[The above requested information may be found on p. 441]

Mr. MADIGAN. Mr. Nelson Hunt, on March 19 I believe from Paris you announced that you were going to put up 200 million ounces of silver for metallic bonds. Could I ask you what you intended to do with the proceeds from those bonds?

Mr. NELSON HUNT. That announcement was with a group of people including myself and others, and the funds would be used to finance various businesses.

Mr. MADIGAN. Could you tell the committee what the current status of those plans is?

Mr. NELSON HUNT. Well, they are in abeyance at this time.

Mr. MADIGAN. Let me ask both of you gentlemen, I think that I have time for only one last question. I would like to ask each of you if either of you know how much silver, how many ounces of silver the two of you together have physically taken possession of since 1973.

Mr. HERBERT HUNT. Mr. Madigan, I don't. I don't have any idea of what my brother Bunker Hunt has done, and as far as my own, I would have to go back and run a calculation, because while I have taken delivery of silver or acquired silver or bought silver in many different forms, at times I have had to dispose of silver for financial reasons, and I would just have to go back and try and calculate how much silver I bought over that period of time. I just don't know.

Mr. MADIGAN. The position of other big traders in the silver market would certainly have some bearing on the worth of your investment, but you, Mr. Herbert Hunt, as I understand, would have the committee believe that you did not know the position of your brother as you were buying and selling silver. Is that correct?

Mr. HERBERT HUNT. No, I knew in a general way that he was very bullish on silver, but as far as knowing what his positions are, how much silver he owned, I did not.

Mr. MADIGAN. There have been newspaper accounts that the two of you together own jointly 150 million ounces of silver. Is that a reasonably close estimate of your holdings in silver?

Mr. HERBERT HUNT. As I say, I am not sure exactly what all his holdings are. It would be way in excess of mine.

Mr. MADIGAN. I see that my time has expired. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Madigan.

Mr. Harkin.

Mr. HARKIN. Mr. Chairman, I don't have any particular reason for saying that the Hunt brothers sitting here ought to be exempt like anybody else in terms of the press, but I don't think any witness regardless of his stature ought to have to put up for an hour at a time with clicking pictures. I would like to ask unanimous consent—they have had their chance—if the photographers here might retire to the back of the room during the proceedings.

Mr. JONES of Tennessee. Thank you, Mr. Harkin. Without objection, we will ask the still photographers to retire, who are really creating the problem that Mr. Harkin is discussing, and I certainly share the position that you have taken. I am sure all other members of the subcommittee do too.

Mr. Huckaby, I recognize you for 5 minutes.

Mr. HUCKABY. Thank you.

Mr. Hunt, could you give me some approximations, the number of contracts, futures positions did you hold in July 1979?

Mr. HERBERT HUNT. Mr. Huckaby, I am sorry.

Mr. HUCKABY. 600,000, 10,000, 50,000?

Mr. HERBERT HUNT. Well, it would be in excess, I am sure it would be in excess of a number of thousand, but I really don't know because, you know, when you are in the market, and your position is changing every day—

Mr. HUCKABY. Right, but surely you must have some kind of reports to give you averages of some type of monthly analysis?

Mr. HERBERT HUNT. Oh, yes.

Mr. HUCKABY. But you are in the neighborhood of 2,000, you say?

Mr. HERBERT HUNT. No, I am saying it is in excess of 2,000. I don't know what it was at that time. I get a daily report, but, you know, once the day is over, why, it has served its purpose. Mr. Huckaby, we do make reports as required by the CFTC. They have position limits, and every time I hold—reporting limits I should say. Every time I hold more contracts than the minimum, I report it to the CFTC, and I hate to say it. They can probably furnish you the figures better than I can.

Mr. HUCKABY. You are reporting the 5 percent, then, in July. You were above the 5 percent level?

Mr. HERBERT HUNT. Five percent?

Mr. HUCKABY. Yes.

Mr. HERBERT HUNT. I don't know that that is the reporting limit. It is the number of contracts that you must be above, and you report if you are above that number of contracts.

Mr. HUCKABY. What is that number?

Mr. HERBERT HUNT. I really don't know, because I don't handle that. It is either 100 or 200 contracts. It is relatively nominal, I think.

Mr. HUCKABY. Would it be fair to say that your position was somewhere between 2,000 and 10,000 contracts in July 1979?

Mr. HERBERT HUNT. 2,000 and what?

Mr. HUCKABY. 10,000.

Mr. HERBERT HUNT. Yes, it would be fair to say.

Mr. HUCKABY. You would be somewhere in that range. Did you further increase your position after July 1979?

Mr. HERBERT HUNT. Well, as I say, the position—

Mr. HUCKABY. Significantly?

Mr. HERBERT HUNT [continuing]. Is traded on a day-to-day basis, and I don't know that my position did materially change after July. My personal position I don't believe did materially go up.

Mr. HUCKABY. Did you feel that you held more futures positions than there was silver available for delivery at any time during this period July to December 1979?

Mr. HERBERT HUNT. No, absolutely not.

Mr. HUCKABY. If you were basically in the \$10 to \$12 range for the majority of your holdings, and all indications are that you have taken significant losses since this period of time, how did this take place?

Mr. HERBERT HUNT. The silver futures contracts that I had were where you put up a margin, so literally as you took some silver you

had to come up with the full amount, so that utilized some of the funds.

Second, a big factor is that the exchanges changed the margin requirements and made the margins so high that they virtually converted the market into almost a cash market. For example, at \$65,000 a contract margin, that is \$13 an ounce, so literally the bulk of my funds were tied up by the exchanges in raising the margin requirements so high that I had to put up large amounts of funds on the futures contracts that I had.

Mr. HUCKABY. Do you have any idea, could you estimate how much you have lost since 1979 in the silver market?

Mr. HERBERT HUNT. Since when?

Mr. HUCKABY. Since January 1979.

Mr. HERBERT HUNT. Well, I can't, because they are still trying to get all the records and calculate it out. I am guessing it is going to be still weeks or months before they have such calculation run, and of course, loss, you know, just because you have something that is worth more on paper doesn't mean you have made money, so I don't know that I could answer the question you are asking until the calculations are run and I see exactly how the positions were closed out by the brokerage houses.

Mr. HUCKABY. One final question. You have been extremely critical, perhaps justifiably so—we don't know at this point in time, at least I don't—of the way the market was handled. Would you favor legislation that would require a sliding scale of margin as one's position increased, so that at least one would know the rules of the game as they entered in the market on the scale that you are in?

Mr. HERBERT HUNT. Well, yes, I think it is always definitely fair to everybody if they know what the situation is going to be in advance, and if a sliding margin where you say you should have up 10 percent or 15 percent or 20 percent at all times, and the price goes up and it requires more margin. Everybody knows this, and I think this is one way of being fair to everybody involved.

Mr. HUCKABY. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Huckaby. Now 5 minutes to Mr. Glickman.

Mr. GLICKMAN. Thank you, Mr. Chairman. I would just make a comment before we start. I recall when I saw "Fiddler on the Roof" the protagonist of that story was told "Well, there is no great disgrace in being poor," to which he responded, "Yes, but there is no great honor either." Today you folks are being subject to the honor of being rich and participating in the market and being subject to legislative prerogatives, we have to make sure that the market works, but I come from this to try to determine whether legislatively the market does work, that people are adequately being protected, and I would like to ask several questions and maybe Mr. Bunker Hunt would answer some of them too.

Are you saying that the exchanges are so incapable of fairness or riddled with conflicts of interests that a Federal agency like the CFTC should have the ultimate authority to set margins as opposed to the exchanges? Mr. Bunker Hunt, Nelson Bunker Hunt.

Mr. NELSON HUNT. Well, I believe the law requires that the markets be price neutral, market neutral. They don't have the right to conduct their affairs in such a fashion as to force an item

up or to force it down. That is manipulation, and I believe that the market should be handled in such affairs as not to do that, to be neutral, and I don't know what it takes to get it there, but of course I think the problem is that most of the people on the board of governors are shorts, and they represent shorts, and they make their profits that way, and so they like to see these markets come down, and they short the market.

Mr. GLICKMAN. So what you are saying, the current system is not fair?

Mr. NELSON HUNT. I would say the way the silver market has been handled, the way some of these other markets have been handled at times it is not fair. Of course, as to whether the CFTC would be fair I don't know. They might get pressure from other Government agencies to not be market neutral, although I think the law does require that they be market neutral.

Mr. GLICKMAN. I would like to get to the other issue, and that is the relationship between you and Bache Halsey Stewart. I believe that the record is that you, both of you individually or together, own stock in Bache Halsey Stewart, a brokerage firm, and I believe in the aggregate your family owns more than 5 percent interest in that company, and I believe you are one of the larger stockholders of the company. And as I also understand it, a majority of your silver futures activity, the transactions were placed during 1979 through Bache Halsey Stewart, and instead of having to put up cash or something liquid as your margin with Bache Halsey Stewart you actually borrowed from them. Is that a correct statement?

Mr. HERBERT HUNT. No, that is not correct, Mr. Glickman. First of all, let me say that Bache is one of the brokers that I do do business with. I am talking about myself personally. It is not the only brokerage house that I do business with. I do business with several other brokerage houses.

Anytime I had a position with them, they called for an initial margin of cash, and I did put up the initial margin of cash with them.

As I testified, where I had the problem in coming up with funds was when the market had risen to higher levels and was forced to back down, and the margins had been raised so high that it had the bulk of my funds tied up in what had now become the new initial margin. As the price declined, I was called on for various margins.

Mr. GLICKMAN. But your initial margins were cash?

Mr. HERBERT HUNT. They were cash.

And the variation margins I was called on for I needed to raise funds, and I did make inventory-type loans in which I pledged silver with the commodity brokerage houses, and took those funds and used them to meet margin costs.

Mr. GLICKMAN. Let me ask you this final question. If your initial margins had been of the type that you talked about with Mr. Huckaby, let's say a 10-percent margin or a scaled margin, if the margins would have been higher initially, would you have purchased the quantity of silver futures? Would you have invested as heavily as you otherwise did?

Mr. HERBERT HUNT. Well, actually the margins were higher earlier, as I think I testified in my statement, say approximately

\$2,000 at 5,000 ounces to a contract that is \$2 an ounce, and when I was buying silver at $8\frac{1}{2}$, that was over a 20-percent margin.

Mr. GLICKMAN. What if the margin would have been a \$5,000 a contract initially?

Mr. HERBERT HUNT. At that level? Well, obviously if I wanted to buy futures contracts I would have had to have put it up, and I probably would have, but of course you reach the point that your margins become so high that it is no longer an attractive investment, and so high margins do make markets illiquid.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman. And now to Mr. Richmond for 5 minutes.

Mr. RICHMOND. Thank you, Mr. Chairman.

Mr. Hunt, I would like to change the subject, if I may. I would like to discuss sugar. I think your positions on silver have certainly been well publicized. Can you tell me what your particular interest in sugar is right now? Are you a producer? Are you a speculator? Are you an operator of sugar mills? What is your actual position in sugar right now?

I might say to open, I am concerned about sugar. The price of sugar in the last year has risen 400 percent. I wonder if there is any type of manipulation in the sugar market. I also wonder if the American consumers are being subjected to the same problems we have had in other markets such as silver. So tell me, if you will, what your interest is in the whole area of sugar.

Mr. HERBERT HUNT. All right. Some of the Hunt family own a company which is a producer and refiner of sugar.

Mr. RICHMOND. What is the name of the company?

Mr. HERBERT HUNT. Great Western Sugar, and Godshaw Henderson. Great Western Sugar is involved in the refining of sugar beets, and Gottshaw-Henderson is involved in the refining of cane sugar. I might also mention the firm is also building a plant to produce fructose sugar, which is made from corn, so they are a company that is involved in producing and selling and marketing sugar. What can I add?

Mr. RICHMOND. Are you also trading on the New York Sugar Exchange?

Mr. HERBERT HUNT. Are you talking about directly myself?

Mr. RICHMOND. Well, I think we all think of the Hunts as a family of investors, traders, and what have you, so my question is: Is the Hunt family involved in either hedging or speculating in sugar or buying or selling sugar contracts on the New York Sugar Exchange?

Mr. HERBERT HUNT. Well, let me say personally, I can speak for myself. I have a very small sugar futures position that I have had for some time, I guess 6, 8 months, something like that. I am an officer of the company that owns Great Western Sugar, and they do use futures contracts from time to time in their operation. I don't keep up with what those are on a day-to-day basis, but I know that they are involved in the sugar market.

Mr. RICHMOND. Can you explain why within 1 year the price of sugar went from 9 cents to where it is now at 37 cents a pound?

Mr. HERBERT HUNT. Well, I have my own ideas. I am not sure I am 100 percent right, but sugar is a market that is subject to

supply and demand like any other market or any other commodity, and actually sugar at 9 cents is a money loser for the grower and producer. I have been told there are numerous factors that are making the price of sugar move: One, the Cubans had a problem when the hurricane came across the island down there in the last hurricane season, and is supposed to have badly damaged their crop.

Two, you have a drought situation. Well, first you had an early cold situation in which in Russia they had lots of snow and couldn't get the crop in. And now I understand they are having a drought situation on top of that, so the Russian crop is supposed to be down.

Thailand, who is a producer of sugar, just recently force majured on some of their contracts because they had crop problems. Then in addition, I am told that there was an agreement among the producers of the world in which they would market sugar on a restricted basis, and there is now some suspicion that the countries didn't stick to the restricted basis but sold more than they were reporting and that is why the price was done, and now that there is not as much sugar around as everybody thinks, so literally I think it is a matter of supply and demand.

Mr. RICHMOND. What about possible speculation and market manipulation on the sugar exchange in New York City leading to higher prices?

Mr. HERBERT HUNT. I don't have any real feel for whether there is or not, because I am not involved in it myself in a big way. My brother just mentioned to me one other thing that I failed to mention, that Brazil is moving more and more of their sugar into alcohol production because of the higher crude prices, and they are basically an importer of crude.

Mr. RICHMOND. Would you and Mr. Nelson Hunt both say in your opinion there is or there isn't any undue speculation on the New York Sugar Exchange?

Mr. HERBERT HUNT. At this moment?

Mr. RICHMOND. Yes.

Mr. HERBERT HUNT. I don't really feel that there is. I know the price of sugar has moved a long way. I think it got as low as 7 cents. It has been as high as 37 cents recently on the market, which is a very sizable move, there is no question about it. But it is a matter of supply and demand.

Mr. RICHMOND. Thank you very much. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Richmond. Now the chair recognizes Mr. Coleman for 5 minutes.

Mr. COLEMAN. Thank you, Mr. Chairman.

Mr. Hunt, it has been widely reported that you received, an \$800 million loan with the aid or assistance either of the administration or the Federal Reserve. Is that true?

Mr. HERBERT HUNT. No, Mr. Coleman. I have not received any loan, but I don't want to be misleading. There is a Hunt company, which is Placid Oil Co., that has negotiated a sizable loan, I believe it is in excess of the \$800 million.

Mr. COLEMAN. Was this loan obtained with any assistance by the administration or the Federal Reserve?

Mr. HERBERT HUNT. I did not handle the loan, but to my knowledge there was no assistance from them.

Mr. COLEMAN. I understand the loan in question is a loan to pay back companies or corporations owned or controlled by you or your family; is that correct?

Mr. HERBERT HUNT. Placid Oil Co. is a company that is owned by a group of trusts that are Hunt member trusts, Hunt family trusts, and that loan that has been arranged is a line of credit that they will draw on for numerous needs. They are pledging collateral, oil and gas collateral, and this sort of thing, to secure the loan. A portion of those funds from the loan will be used in a partnership which will involve my brother and I and a third brother, in which we are placing assets consisting of silver and securities and cash and T bills and coal properties and this sort of thing.

Mr. COLEMAN. Mr. Nelson Hunt, you have no personal knowledge that any arrangement for this loan was made by the administration or the Federal Reserve?

Mr. NELSON HUNT. No, sir, I don't have any knowledge that they were of any help, but I would assume—of course, I shouldn't assume; my lawyer told me not to—that they didn't oppose it because I don't know whether the banks would lend it otherwise.

Mr. COLEMAN. I assume that neither one of you had any communication directly with the administration or with the Federal Reserve or anybody acting on your behalf had such a conversation?

Mr. NELSON HUNT. No, I had none whatsoever.

Mr. HERBERT HUNT. I did not.

Mr. COLEMAN. Thank you.

Did you have to sell any large quantities of grain in order to finance your silver transactions?

Mr. NELSON HUNT. Of grain?

Mr. COLEMAN. Yes.

Mr. NELSON HUNT. No, sir.

Mr. HERBERT HUNT. I owned some grain futures contracts which I did sell, in order to get the margin money, yes.

Mr. COLEMAN. Do you have an estimate on the number of those?

Mr. HERBERT HUNT. It wasn't significant. I really don't know right offhand, but it wasn't material.

Mr. COLEMAN. If you gentlemen feel that the exchanges acted unfairly, and in fact prejudiced your own positions, is it possible or why didn't you or will you shift your transactions to exchanges outside this country, for example, in Hong Kong, Zurich, and other world points?

Mr. HERBERT HUNT. If the question is directed to me, I would say that I am doing business, have done business with the foreign exchanges, in particular London. Zurich is more of a cash market or a forwards market, and I have done business there also. I think we are seeing more of the business move overseas.

Mr. COLEMAN. Do you have any personal knowledge of any brokerage firm or financial institution that in fact was threatened with collapse because of financing arrangements that they had made with you or with any corporation owned or controlled by you in dealings with your silver financing transactions?

Let me also say that this was stated by Chairman Stone of the CFTC as a reason why he feels that something needs to be done

through more Government regulation. I have yet to find anybody who agrees with him that any financial institution was threatened, but I ask you if you have any such knowledge of any brokerage firm or financial institution being threatened because of these outstanding loans to you.

Mr. HERBERT HUNT. Well, I am not sure of the word threaten, but obviously I had financing with Bache and Ackley and Merrill Lynch, and when the price of silver came way down, those loans became uncollateralized. In other words, when you finance an inventory-type loan such as silver, grain, or what have you, you usually borrow less than the value of the item you are financing, substantially less, more like 60 percent, 65 percent of the true value at the time you finance it. And of course when the price came down, those loans were in effect in default, and therefore those companies were placed in the position of having to sell that collateral to recoup and pay their loans.

Now, where it stood as far as their total firm stands, I am not privy to that.

Mr. COLEMAN. You do not know or have not heard?

Mr. HERBERT HUNT. Well, I have heard what you have heard, that they were having problems.

Mr. COLEMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Coleman.

The chair recognizes Mr. Baldus for 5 minutes.

Mr. BALDUS. Thank you, Mr. Chairman.

Going back first of all to the loans from the brokerage houses. When we had the brokerage houses here they responded to the question saying they seldom made loans or they hardly ever made loans and they didn't remember very much about loans. Could you characterize the kinds of loans you made with brokerage houses? You said brokerage houses did make loans to you; were they significant, or insignificant?

Mr. HERBERT HUNT. Oh, they would be significant transactions.

Mr. BALDUS. What companies?

Mr. HERBERT HUNT. Ackley, Merrill Lynch, Bache, Hutton, also had some financing with Hutton.

Mr. BALDUS. And these were when the market was coming down or the margin requirements were being increased?

Mr. HERBERT HUNT. No, I think loans—I am not sure exactly when the loans were put on with the different brokerage houses, but obviously in any kind of commodity basis, operation or business, you are always financing a part of your inventory, which in this case was silver. So we had loans from time to time that were arranged by my financial man, and I am sure that from time to time some came due, some were paid off, some were renewed, and this sort of thing. It is an ongoing, continuing operation.

Mr. BALDUS. It was sort of a rolling loan proposition going on with companies you mentioned?

Mr. HERBERT HUNT. Yes, that is correct.

Mr. BALDUS. And they would be significant propositions?

Mr. HERBERT HUNT. Yes.

Mr. BALDUS. And that would be a matter of public information at the time?

Mr. HERBERT HUNT. No, I don't think so, unless the brokerage houses have to file that, being public companies, have to file that. But I don't believe it would otherwise.

Mr. BALDUS. You feel that the action of the exchanges put you in an adverse position, and in your testimony, although it is in the form of questions, perhaps not direct allegations that it was deliberate and that they may have profited, are you anticipating any legal action? Have you made those complaints to any member of those commodities or through your own traders or representatives?

Mr. HERBERT HUNT. I stated in my statement that I did meet with the exchanges on numerous occasions, at their request on some occasions and at my request on some occasions, and was very open and frank with them and discussed that the actions they were taking are not market neutral. In other words, they were going to make the price go up or down. They were not being neutral, and did discuss this quite at length with them, and argued with them about the actions that they were taking.

Mr. BALDUS. I don't know if you answered the question. Do you consider them illegal?

Mr. HERBERT HUNT. Yes, I think that they're not permitted to take actions that are not neutral.

Mr. BALDUS. Are you preparing any legal action? Would Mr. Goldberg choose to answer?

Mr. Chairman, is Mr. Goldberg—

Mr. HERBERT HUNT. He is my legal counsel.

Mr. BALDUS. Does he choose to answer?

Mr. HERBERT HUNT. No, I just looked to him. I would prefer to say that I have not arrived at the conclusion that I will take legal action or will not. We are discussing it.

Mr. BALDUS. At the very least you consider that it is misconduct upon which you could challenge the membership in those exchanges?

Mr. HERBERT HUNT. I do.

Mr. BALDUS. And are you considering that action?

Mr. HERBERT HUNT. We are discussing such action.

Mr. BALDUS. Could you identify the shorts, because obviously the shorts were very large. Now I understand those are public information. Could you identify for our convenience now who were major shorts who profited considerably?

Mr. HERBERT HUNT. Well, it is not public information. You probably have the information which you can acquire from the CFTC, because certainly they must file reports also. I do not have it per se. I have a feel for what is going on in the market.

Mr. BALDUS. There is one of them that was over \$100 million. Could you identify that one?

Mr. HERBERT HUNT. Yes, that was a public announcement by Armand Hammer of Occidental Petroleum. That is the only reason I happen to know about that one.

Mr. BALDUS. Any others that come to mind?

Mr. HERBERT HUNT. I don't know yet specifically who they are or what their positions are.

Mr. BALDUS. Does Mr. Goldberg?

Mr. HERBERT HUNT. No, he does not either. I mean, this is a matter that would be filed with the CFTC that I would assume your committee would have access to. I don't.

Mr. BALDUS. One other question, and it has to do with the bonds. Were those bonds to be marketed in this country, anticipated bonds that you intended to sell? Nelson Hunt answered the question before but not completely.

Mr. NELSON HUNT. No, it was not anticipated.

Mr. BALDUS. Was there to be security? What was the security of the bond, what was the purpose?

Mr. NELSON HUNT. They would be secured by silver. The details hadn't all been worked out. It was preliminary—

Mr. BALDUS. Who did you intend would buy the bonds?

Mr. NELSON HUNT. People outside the United States who would be interested.

Mr. BALDUS. They would be secured by silver you hold in inventory and secured by the Hunts, would they be the guarantor behind the bonds?

Mr. NELSON HUNT. Hunts and possible banks.

Mr. BALDUS. Did I understand you made an announcement you were going to be selling these bonds? This was about the time the silver market broke, but some days preceding that?

Mr. NELSON HUNT. It was projected that there would be bonds sold.

Mr. BALDUS. Were they ready to be merchandised at that time?

Mr. NELSON HUNT. No, they weren't ready at that time.

Mr. BALDUS. My time is up. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Baldus.

The chair recognizes Mr. Bedell.

Mr. BEDELL. Thank you, Mr. Chairman.

Messrs. Hunt, either Herbert or Nelson Bunker, you indicated that you thought it was because of the activities of the exchanges which were nonneutral that caused the problems. Had it not been for these activities, and the price of silver reached \$50, do you think that would have gone down, up or stayed the same at that time?

Mr. HERBERT HUNT. I literally think that the action of the exchanges caused the price of silver to spurt up to the \$50 and to take the crash also. Literally the exchanges, by creating the tremendous margin along with the—well, by putting on the tremendous margin requirements of \$65,000 per contract, placed many futures owners in the position they had to get out regardless of what happened because they did not have the funds for the margins.

Mr. BEDELL. I don't see how that would push the price up.

Mr. HERBERT HUNT. If you have shorts, they have to be covered regardless, and there are always some small people on each side in the market and they have to buy those shorts regardless and you have an illiquid market, that market goes through tremendous gyrations in price.

When those margins were put on, it pushed the price up on one day to approximately \$50 for a moment or two, and of course, once those people got out of the way, then it placed the market still in the situation where there was nobody to buy on the other side.

Mr. BEDELL. So it took the people out of the short market as well as those out of the long market, you were saying.

Mr. HERBERT HUNT. It, in effect, made a violent market out of it; made it go up and down.

Mr. BEDELL. The problem that troubles me as an individual, and as we try to write laws for our society and determine what we should do, I am sure this is true of a lot of people, is to try to understand what it is that causes the Hunts to do the things that they do, and if your financial situation is as I understand it, then it is kind of hard to understand why it would be that you would try to be building more and more billions of dollars.

It may be a game that you get into that makes sense, but it appears to me what you have done is first of all, you have given the perception, at least, that what you were doing was trying to corner the market. Whether you were or not, that is the perception that exists, and in doing that, that certainly is very detrimental to our national interest.

Certainly the increase of the price of silver to \$50 an ounce when it cost \$20 to mine it in a time of an inflationary period is something that is a problem to our society.

I guess I can't understand exactly what your values are in trying to do something that would appear to be very detrimental to our society which would benefit you some dollars which I don't see how they are of any great benefit to you unless the people around you are pushing for you to try to build more and more wealth to be of benefit to them.

This is something I don't understand, and it would help me in legislating if I understood why it was that you think the way you do.

Mr. HERBERT HUNT. I kind of feel like that is almost "when did you quit beating your wife," Mr. Bedell.

Mr. BEDELL. Is there something I said that is incorrect? The perception is there, is it not?

Mr. HERBERT HUNT. Let me say we did not push the price to \$50 an ounce with our action.

Mr. BEDELL. You testified that the more buyers the more the price goes up, and you had big holdings and those holdings would tend to push the price up which was detrimental to our society.

Mr. HERBERT HUNT. Mr. Bedell, you are taking the point of view that high prices are detrimental on silver. Actually, I don't feel they are detrimental on silver. I think prices need to be at whatever level it takes to get supply and demand in balance.

Mr. BEDELL. You said it cost \$20 to mine it?

Mr. HERBERT HUNT. Well, there is a world shortfall of 200 million ounces of silver a year. In other words, there is approximately 200 million ounces a year more silver used than is produced. And so literally the price needs to go to where it takes to balance out the production of silver.

Mr. BEDELL. The price was \$10 and it cost \$20 to mine it, and apparently you believe it is beneficial to put it at \$50 which causes the price of film to go up and causes problems for—it was a part, certainly the jump from \$10 to \$50 was part of our inflationary problem at the time.

Mr. HERBERT HUNT. Mr. Bedell, you keep stating I put the price of silver at \$50 and I keep telling you I didn't, so I don't know how to answer your question.

Mr. BEDELL. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you Mr. Bedell.

Gentlemen of the subcommittee, there is a vote on the floor of the House to approve the journal. So if anyone wants to stay and ask questions, the chair will remain open. I will stay here and do it.

Mr. Marlenee, you are next. Do you want to stay or go?

Mr. MARLENEE. While I hate to miss a vote, Mr. Chairman, I do have several questions that I want to ask. I would like to reserve my time and run over and vote and be back.

Mr. JONES of Tennessee. Does anyone else want to stay and ask questions?

If not we will recess for 15 minutes.

I would like to announce however, we are glad to have Congressman Neal Smith with us, a former member of this committee and also Charlie Rose was here, a member of the committee.

[A brief recess was taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

At the time of the recess for the vote, Mr. Bedell had finished his time for questioning and Mr. Marlenee is now recognized for 5 minutes.

Mr. MARLENEE. Thank you, Mr. Chairman.

Herbert and Nelson, the Hunt brothers, the contention has been made that CFTC and Comex were protecting the hundreds of thousands of small investors, but you state that by requiring higher and higher margins that the market was in fact and in effect closed to small investors.

My status sheet shows in early 1979 your position was 8,354 contracts, the two of you together. In February 1980, you, Herbert, had 1,487 contracts. On February 4, the margin was set at \$60,000 to \$75,000 and at about that date on March, the futures declined to \$10.80 an ounce and you went from 1,463 to 952 contracts.

Several questions arise from this.

Did these actions—and I am talking about the actions by the boards—force you to liquidate the contract, were they the primary reason to liquidate?

Mr. HERBERT HUNT. Yes, Mr. Marlenee.

Mr. MARLENEE. I believe that has been documented by your statements before the committee already.

Mr. HERBERT HUNT. Yes. As a matter of fact, the Comex in putting on a limit, as well as the Chicago Board of Trade putting on limits, you had two choices, either you could sell them into the market where there were no buyers, or limited buyers, or else you could do what are known as EFP's, exchange of physicals for actuals or for futures contracts, and so in order to get down on the number of contracts in some cases I was forced to go through this procedure to—

Mr. MARLENEE. Did these actions force not only you, but thousands of small investors to liquidate contracts at a loss, in your opinion?

Mr. HERBERT HUNT. Well, certainly the action of the increased margin forced small speculators to liquidate. In other words, they had a contract. They had started out with \$2,000 or \$2,500 margin. The margin was bumped to \$20,000 and then \$65,000 on one contract—

Mr. MARLENEE. So the small investor could not hang on?

Mr. HERBERT HUNT. How many small investors can come up with \$65,000 to own one contract.

Mr. MARLENEE. When you have contracts going to the market, you are selling, could it be said these actions by the board forced the market down and caused not only your loss, but losses to thousands of other small investors?

Mr. HERBERT HUNT. There is no question about that. I couldn't agree with you more.

Mr. MARLENEE. If in fact this was the action by these various boards of forced market manipulation, is this an illegal action?

Mr. HERBERT HUNT. Yes, I certainly believe it is. It certainly is not market neutral.

Mr. MARLENEE. Now it has also been stated in this committee that there are hundreds, several hundred thousand shorts. Are there that many shorts?

Mr. HERBERT HUNT. No.

Mr. MARLENEE. Are there thousands of shorts?

Mr. HERBERT HUNT. Well, we must qualify this as to time frame. When the market was totally liquid, 1½ to 2½ years ago, why, you got as many as 300,000 contracts open interest on Comex alone, I believe. And yet Comex today is down to just over 20,000 contracts.

Mr. MARLENEE. What I am trying to arrive at, are there more longs than shorts, about what is the ratio?

Mr. HERBERT HUNT. There must be a long and a short.

Mr. MARLENEE. But it could be varying amounts. Individuals I am talking about.

Mr. HERBERT HUNT. Oh, individuals, as groups. I don't know that I have a real feel for that but normally the trade are the principal shorts. Their business is buying silver and selling short in the market and delivering the silver.

Mr. MARLENEE. You made the statement, Herbert, that a relatively small number of people benefited from this market decline, from these increased margins, and those people being the shorts.

Mr. HERBERT HUNT. Yes.

Mr. MARLENEE. And I certainly don't condone what has happened, the actions that have taken place, that have caused the disruption, and I don't condone the loan, but on the same hand, I think we need to investigate and look at the accounts of the commissions, and the boards, because a relatively small number of people benefited and those are the shorts.

Mr. HERBERT HUNT. That is correct.

Mr. MARLENEE. Causing losses of hundreds of thousands of dollars, millions of dollars to maybe thousands of people.

Who was the principal beneficiary, in your opinion, of your misfortune of the decline in the market? Do you have any—

Mr. HERBERT HUNT. Well, I think—of course, I can only have suspicion, because I am not entitled to information on what other

people's positions are but basically it would be the trade, the firms that are in the business—

Mr. MARLENEE. Wasn't Armand Hammer the principal beneficiary of somewhere between \$100 million and \$200 million?

Mr. HERBERT HUNT. He so stated publicly. I do know about that one. His company, Occidental Petroleum Co., is in the oil business.

Mr. MARLENEE. I think the question that should be asked is does he or any of his corporate officers have any decision or any position on the policymaking boards of the various futures trading commissions in this case. Would you agree with that?

Mr. HERBERT HUNT. Or was he alined with somebody that did.

Mr. MARLENEE. Yes. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Marlenee. And now since neither Mr. Hopkins, nor Mr. Daschle are here, we are going to begin the second round. I am going to, without objection, yield to Mr. Harkin for 5 minutes.

Mr. HARKIN. Thank you, Mr. Chairman.

The dean of our delegation from Iowa is here, the Honorable Neal Smith, who is also chairman of the Small Business Committee and who has had interests and knowledge of this area, and if it would be permitted by the chairman, I would like to yield the time to him.

Mr. JONES of Tennessee. Without objection, we will be glad to hear from Neal.

Mr. SMITH. Thank you very much for yielding.

I heard mentioned several times today that the clearinghouse and the board of directors should be market neutral. I couldn't agree more with that. I also happen to be one who thinks that of the alternatives presented it is best for the exchanges to set margins, but I also am very aware they can abuse the discretion.

So my question is: Do you think that it is really possible for them to be market neutral or that there should be some limitation when on the clearinghouse, in some instances, or board of directors that sets these levels, a majority of those members have positions on the very contracts they are setting margins on?

Mr. HERBERT HUNT. They should be market neutral. Whether they can or cannot I don't know. In this case they definitely were not in my estimation.

Mr. SMITH. Would there be some protection against this if there were a requirement that a substantial majority of the clearinghouse or the board of directors, whichever it happened to be, not have positions in the contracts that set the margin?

Mr. HERBERT HUNT. Yes, that would be a step in the right direction, but obviously we all recognize when you get a group together to create actions, usually 2 or 3 carry the day when there are 20 or 30 in the room.

Mr. SMITH. I recognize that and I think we cannot expect to have a situation where nobody on the board has a position in the contract, but at least a majority who participates in the decision should not have a position in the contract when they are setting margins or have a financial interest in the decision, would you agree with that?

Mr. HERBERT HUNT. I would agree with that.

Mr. SMITH. How about Nelson?

Mr. NELSON HUNT. Yes, I would agree with that, but I think you could have a situation where 75 percent might have no position and they will defer to the wishes of the 25 percent that have a position. In other words, these fellows meet together practically every day or at least a couple times a week, and they get to be sort of a pretty close club, you know, and that is the problem.

Mr. SMITH. And another thing about market neutral. How can it be market neutral when a half dozen big grain companies sometimes have inside information for as much as 18 days before the rest of the world knows about it, and many of the other people that are in the market? Should big grain companies like that have to report their positions within 24 or 48 hours so that everybody that is in the market is on the same basis and knows what the supply and demand is?

Mr. NELSON HUNT. I would think that to be fair about it, I would think that the more often they report the better.

Mr. SMITH. How about you?

Mr. HERBERT HUNT. I would agree with this.

Mr. SMITH. Thank you very much.

Mr. HARKIN. Thank you, Mr. Chairman. I just wanted to follow up again on my line of questioning earlier. It seems that what you have here is you have some winners and some losers, both very powerful and very big.

Dr. Armand Hammer is no small potatoes, and neither are the Hunts.

Now, had the market not fallen, had the market continued to climb, had you increased your holdings, I don't know about increasing your holdings, but I just see here from the report of the Senate staff, report of the Commodity Futures Trading Commission, the one from which you cited earlier, that as of December 27 the Hunts and IMIC, that is the one I guess from Bermuda, I guess, I don't know if that is the same one or not, controlled 53 percent of the Comex silver stocks and 69 percent of the Chicago Board stocks.

In addition to the substantial holdings of physical silver, the Hunts, IMIC, and the Conti groups still held significantly large future positions, particularly in the March 1980 Comex contract.

Their combined long position in that future totaled 17,787 contracts or 57 percent of the total open interest.

Now, I will take what you say at face value, that you were not trying to corner the market, that the evidence is not that you were trying to. I will take that at face value, but I think the fact is if the price of silver had not fallen, you would have won and Armand Hammer would have lost, and perhaps Armand Hammer would have been here complaining and saying, look, you know the Hunts cornered the market and they shouldn't be allowed to do that.

Again it just appears to me you have very powerful people involved here and very large amounts of capital, and I guess my only concern that I share with Congressman Smith, the chairman, and I am sure every other member, is how do we make sure that that market is in fact as neutral as possible, and I keep coming back to this question.

Do you feel that the CFTC ought to play a larger role, a more involved role in the commodities market more akin to what the SEC plays in the securities market? Do you or do you not?

Mr. HERBERT HUNT. Well, Mr. Harkin, I would have to say that I don't know that I disagree with you. I don't know that I agree with you because it depends on whether the CFTC can be market neutral.

Market neutral themselves. For example, in this report right here, which you referred to and I referred to earlier, I see there that somebody from Treasury was over and asking them to raise margins, and quiet so-called speculation, so literally just reading their own report they come under forces from others in Government also.

Mr. HARKIN. I see my time is up. Just one last question, but would they tend under the scrutiny of Congress and this committee, would they tend to be more fair, more market neutral than the boards themselves, left unhindered?

Mr. HERBERT HUNT. I would hope so.

Mr. HARKIN. Thank you, Mr. Chairman. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Harkin. We have not gone all the way around, because of the absence of some of the members. Mr. Wampler has returned, and he is the ranking member of the full committee, ex officio member of this subcommittee, so Mr. Wampler, I recognize you for 5 minutes.

Mr. WAMPLER. Thank you, Mr. Chairman. At the outset I want to thank both Mr. Hunts for your coming here this morning and for answering the questions in certainly what appears to be a forthright and candid manner, and we are very grateful to you.

I know you are very busy, and we appreciate your coming here today.

Earlier this morning, and I believe both of you perhaps were not in the committee room at the time Mr. Amstutz testified. He was appearing on behalf of the National Grain and Feed Association. He said, among other things, and I want to quote this, "We do not believe any Government agency, no matter how enlightened or well-intentioned, possesses the capability to manage the margin responsibilities for future markets."

Would you generally agree with that statement or not, or do you have any particular views on it?

Mr. HERBERT HUNT. Well, my personal feeling is that governmental agencies do function rather slowly. That is just the nature of the structure of them, and I don't know whether they would be able to take this on, but certainly I think they would tend to be more market neutral or should, and so I really don't know that I necessarily agree or disagree with what he is saying. I can see problems both ways.

Mr. WAMPLER. As you know, the volume of futures trading in silver has declined rather dramatically, at least on Comex, since silver future prices reached their low in March.

Mr. HERBERT HUNT. The same is true on the Chicago Board of Trade, too.

Mr. WAMPLER. Yes, and do you believe that futures trading in silver has been seriously hurt by what has happened in silver?

Mr. HERBERT HUNT. Oh, I don't think there is any question about it.

Mr. WAMPLER. You indicated earlier, in response to a question, that you, as an individual, I think, were looking more and more to

trading overseas, and I think you mentioned specifically London as one area that you were looking at or perhaps were becoming more heavily involved. Will this whole thing eventually drive more trading overseas, in your opinion?

Mr. HERBERT HUNT. Let me make it perfectly clear that I have been involved in the London market in the past, and for some time. Yes, I think that our market, markets here in this country, are failing to function, and we must recognize that silver is an international commodity, and it is an international market. It is traded around the world, and obviously the markets that perform the best are going to be the ones that receive the activity.

Mr. WAMPLER. Earlier in the hearings there was a general characterization by some of the witnesses that what we experienced in the silver controversy was basically the commodity exchanges versus the Hunts and the Arabs. Is that a fair characterization or not?

Mr. HERBERT HUNT. Well, I don't know whether that is a fair characterization, but I think it is more that the exchanges, through their actions I have outlined here, favored the shorts as opposed to the longs in the market.

Mr. WAMPLER. Let me make this one general observation.

I have said this before in the hearings, but, of course, neither of you were present. Speaking only for myself, I was not an enthusiastic supporter of the legislation that created the Commodity Futures Trading Commission because I guess philosophically I tend to think that it is better left to the free enterprise sector and the exchanges themselves to regulate those problems, but we are concerned as a committee about the functioning of the Commodity Futures Trading Commission, and the rather astronomical growth in terms of the numbers of transactions and the dollar volumes that are now being traded in the futures market.

We have heard the general characterization that one of the reasons that trading in securities markets have become less attractive is because the Securities and Exchange Commission has gone too far and has tended to overregulate, where it is felt probably on the other hand that the Commodity Futures Trading Commission has encouraged greater participation, and that is why we see more investors leaving the securities market and going to the futures market.

Is that a fair generalization from your point of view or not?

Mr. HERBERT HUNT. I don't know that I really can answer your question because I am just not that familiar with and experienced with the security market. I am not trying to duck your question.

I know they are subject to tremendous regulations. All public companies are subject to tremendous regulations.

I do know that I have been involved through some of the Hunt family members in a company that was public and the cost of being public was tremendous.

Mr. WAMPLER. Mr. Chairman, I have one question for Mr. Bunker Hunt. You have been quoted as repeatedly saying even during the runup in price that silver was grossly undervalued. My question is, Do you believe that silver was undervalued when it reached nearly \$50 per ounce?

Mr. NELSON HUNT. Well, I have never made any statement as to what the price of silver should be or what the price of gold should be, but I have said that in my opinion in 10 to 12 years you will see a ratio of about 5 to 1, and I still believe that, and I think silver is greatly undervalued in relation to gold, and it has been artificially depressed because of the actions of the exchange, and I think you will see a tremendous recovery. I wouldn't put a time frame to it and I wouldn't put a price to it, but you have a deficit production in the world of approximately 200 million ounces a year, and the assumption is it is not dropping, and I think the price of silver has to go way up.

Mr. WAMPLER. Mr. Chairman, I see my time has expired, and I thank you.

Mr. JONES of Tennessee. Thank you, Mr. Wampler. If you want to remain we will get to you some more a little later. The Chair will now recognize Mr. Glickman for 5 minutes, and then without objection I will recognize Mr. Fithian, who is a member of the full Agriculture Committee.

Mr. GLICKMAN. This question is to either of you. When the market was increasing from \$10 an ounce to \$50 an ounce, weren't you taking profits out of the market in the daily settlement?

If so, just generally what did you do with the money, and why didn't you have the money available when the market fell and you needed to meet various margin calls.

Mr. HERBERT HUNT. All right. I think to characterize them as profits is not a true statement of what they are, because you don't have a profit until a position is closed, but yes, we were receiving funds in the variation margin. Now, as I stated earlier, the exchanges raised the initial margin requirements on a retroactive basis to very high levels, so a good part of those funds that I took in went into putting up the additional margin, the additional variation margin.

In other words, when you raise the margin from \$2,500 to \$65,000 a contract, you have to come up with lots of money, and that is what has taken place.

Then, in addition, as I further testified, in order to get the positions down to meet the maximum limits that were allowed, I did make some what were known as EFP exchanges of futures for physicals, and when you do that you have to come up with the full price of the silver, the full cost of the silver, and that utilized some of the funds, which again that was caused by the exchanges retroactive limits on numbers of positions.

Mr. GLICKMAN. You also mentioned that at one time the margin on silver was \$2—\$2,000 per contract; \$2 would have made it easy.

Mr. HERBERT HUNT. That does amount to \$2 an ounce.

Mr. GLICKMAN. But over time it was raised to \$75,000 per contract, and you state that this increase contributed to the decline in the market ultimately, but isn't the ratio of a \$2,000 margin per contract at \$10 an ounce the same as the ratio of \$75,000 per contract for a \$50 per ounce price?

Mr. HERBERT HUNT. No, I don't believe so.

Mr. GLICKMAN. What would be the same ratio? Would it just be five times that or \$10,000?

Mr. HERBERT HUNT. It would be five times it.

Mr. GLICKMAN. Would there have been any problem with raising the margin to \$10,000 when the price of silver had increased five times?

Mr. HERBERT HUNT. I am sorry. I didn't—

Mr. GLICKMAN. Would you have had similar problems with what the boards of trade did if the margin had been increased the same rate as the price had increased, five times?

Mr. HERBERT HUNT. It would have lessened the problem. You still have the problem of the limits of contracts and the fact that I did have to go to some exchange of futures contracts for physicals in which case you had to come up with the full value of the silver.

Mr. GLICKMAN. When the brokers were here, Bache Halsey Stuart, Paine Webber, E. F. Hutton, and the group, I asked them whether you would be characterized as speculators or hedgers, and there is an unequivocal response that you were speculators. Would you comment on that?

Mr. HERBERT HUNT. Well, I consider myself an investor because I have been investing in silver since 1973. I have owned silver bullion virtually all that time if not all the time, and have been in the silver market. I hardly call being involved and having my money involved in something for 7 years as speculation.

Mr. GLICKMAN. But from a legal definition, of course, your lawyers would probably be better to answer that, is it correct that you would be categorized under existing rules, both by Federal Government and by the exchanges, as a speculator in silver?

Mr. HERBERT HUNT. I don't really know. I don't think so.

Mr. GLICKMAN. They categorized you as such. I just thought I would, you know, bring that point out.

Let me ask you this question.

Mr. Harkin alluded to this before. Did you have the capability, and I am not asking for the inclination, because I think you have already testified as to your motives in purchasing of silver futures, but did you have the capability of purchasing enough silver to control the market, international market in silver?

Mr. HERBERT HUNT. No, I did not have the financial capability to have control.

Mr. GLICKMAN. How about you, your brother and all the family interests, directly or indirectly, did you have that capability?

Mr. HERBERT HUNT. I don't believe so.

Mr. GLICKMAN. Did you in any of these contract purchases act indirectly with any—I have read statements in the news media that you may have had partners in some of these ventures, is that correct?

Mr. HERBERT HUNT. International Metals Investment Corp. is a corporation that was set up, and there are other owners in it.

Mr. GLICKMAN. Are any of them Arab interests?

Mr. HERBERT HUNT. Yes, they are Saudi Arabia interests.

Mr. GLICKMAN. Let me just ask you one final question. I see the time is up. Is it true that—we have been trying to get into the nature of the futures markets and how it has changed over the last 10 years?

Do you see an enormous increase in both public and speculative interests in futures? You gentlemen have been in business for years. You have invested, I assume, in securities and in commod-

ities and now in futures markets. Do you see a significant change in terms of public speculative interest in these markets? Mr. Bunker Hunt, do you want to answer?

Mr. NELSON HUNT. I would say that since the decline in the silver market caused by the manipulation of the exchanges that I believe this is right, that the amount of trading in all of the futures market has declined very markedly.

It has caused people to lose confidence, and as to what the future holds, I don't know. Maybe they will get over it and maybe they won't.

Mr. GLICKMAN. Do you agree with that, Mr. Herbert Hunt?

Mr. HERBERT HUNT. Yes, I think I would agree with that.

Mr. GLICKMAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Glickman.

Now the Chair will recognize Mr. Fithian for 5 minutes.

Mr. FITHIAN. Thank you, Mr. Chairman. I would like to ask the first series of questions of Mr. Nelson Hunt. I was quite struck by your testimony in your answer to a question in which you said something as follows: Yet a few shorts controlling the exchanges for their own purposes, it was a classic case.

We were told in testimony by members of the exchanges that members of the board with positions regularly abstained when voting on measures that affected any commodity in which they had a position. Do you believe this to be true?

Mr. NELSON HUNT. Well, they may abstain but it is a very small club, and the club generally works together and votes unanimously.

Mr. FITHIAN. So you are saying that even though they abstained on the actual vote, that the shorts in this case transmitted their influence into action by the exchange. Do I understand you correctly?

Mr. NELSON HUNT. Yes; that is what I would say.

As a matter of fact, on one or two of the key votes I heard it was unanimous, all 25 voted.

Mr. FITHIAN. Excuse me, all 25—

Mr. NELSON HUNT. Yes; 25 members of the Comex board of governors, and I didn't hear about anyone abstaining.

Mr. FITHIAN. So then you are saying that if any of those 25 held positions, then the testimony before our committee, Mr. Chairman, is in error, if I remember that testimony correctly. Is that what you are saying?

Mr. NELSON HUNT. If my information is right as to the votes, a couple of the votes I heard about, it was—

Mr. FITHIAN. Let me pursue this a bit. You said that you had a few shorts controlling the exchanges. The only short that has been discussed here this morning I believe by Mr. Marlenee and others was Mr. Hammer. He is a member of the board of directors of any of the exchanges?

Mr. NELSON HUNT. No; I think he is a friend of some of them.

Mr. FITHIAN. To whom then did you have reference, Mr. Hunt?

Mr. NELSON HUNT. Engelhart, Magarter Metals, Sharps Picksley and most of those people; they are the big shorts in the market.

Mr. FITHIAN. I am sorry I didn't catch the last name.

Mr. NELSON HUNT. I am not sure that is correct. I said Sharps Picksley, but that may not be correct, but the big bullion dealers, Handy & Harmon, may have a man on there. Most all of them have a representative on the board.

Mr. FITHIAN. We have been told repeatedly both in the legislation that we dealt with in the extension of the CFTC years ago and since that the reason the exchanges function is that they are made up of both longs and shorts, and one tends to control; that is, each have positions or each have reasons for the proper orientation of the market.

The conclusion of that is therefore we do not need the Government setting margins. We do not need CFTC directly intervening and so on.

Now, your testimony this morning is quite at variance from anything that has come before our committee in terms of the actual operation of the exchanges. Why is it? What is your definition or your explanation as to why it is that we end up with shorts in control of the boards of exchange, boards of governments at the exchange?

Mr. NELSON HUNT. I think that is the way they were set up. They were set up by the shorts, and the shorts maintain control. For instance, no one ever invited me to go on the board of governors.

Mr. FITHIAN. You have been in the market a lot, and traded on the exchanges a lot. Is there any way that members of this committee could ascertain who is correct here in terms of whether or not the shorts do in fact control the exchanges or whether or not there is a balance as we have been led to believe?

Mr. NELSON HUNT. I guess you could call the members, each one of the board of governors and ask them who they represent, and ask them, but I think it is pretty well known even just in the brokerage community that the shorts run the market.

Mr. FITHIAN. Let me ask one final question to which I would hope that each of the brothers here this morning could respond, Mr. Chairman.

We have been told throughout the morning that your tendency was to roll your contracts forward, that you started in the market in 1973 when the price of silver was about \$2.55 an ounce, and we followed this down through a rise in price to \$8.50 an ounce in July 1979, and finally by 1980, and then it drops back to \$11 to \$12 by September 1980.

As a practice, as a general practice, when it came time to do something with your contract, did you at that point simply pyramid it? Let's say it had gone from \$2.05 an ounce to \$5.10 an ounce; did you just double that amount of shares of silver or did you withdraw the profits at the end of that contract and then just reinvest the original amount?

What was the general thrust of your trading?

Mr. HERBERT HUNT. Well, I think the answer to that question as I pointed out in my statement in July 1979, I felt that the economy was in a weakened position.

Mr. FITHIAN. I understand that. Maybe you didn't understand my question. I am talking about the trading up to that July period when you had to roll the contracts forward.

Mr. HERBERT HUNT. Right. Well, what I was leading up to is that literally whether I increased or reduced my positions depended on what I felt the economy was doing and whether it was a good investment or not.

Mr. FITHIAN. But the overall trend was to acquire additional contracts, wasn't it, during this whole period of time?

I mean I am not talking about a daily basis. I am just talking about the trend of the Hunt investments here was to increase your position in the market.

Mr. HERBERT HUNT. I am not sure that is the case because back in 1975-76, some of those times back there, I had positions that were as large as I had—

Mr. FITHIAN. Did it exceed the figures that I believe Mr. Marlenee cited here a moment ago in terms of the total contracts?

Mr. HERBERT HUNT. I am sorry.

Mr. FITHIAN. That would exceed the number of total contracts that Mr. Marlenee cited from the report a moment ago? Is that what you are saying, in 1975?

Mr. HERBERT HUNT. Yes, I am saying in times in the past I have had positions that were larger than—

Mr. FITHIAN. Perhaps the chairman would allow me enough time to have Mr. Nelson Hunt respond as to what your general thrust of trading was, whether you actually took out the profits or simply rolled them over by taking more contracts.

Mr. NELSON HUNT. Well, there was no way to take out any profits in the last 6 or 8 months.

Mr. FITHIAN. No, I was referring from the 1973 to the July 1979 period.

Mr. NELSON HUNT. Well, sometimes I sold some contracts and sometimes I added.

Mr. FITHIAN. But is it your memory that you had more or less, fewer contracts in 1979 as compared to when you went into the market in 1973-74?

Mr. NELSON HUNT. I think I had more.

Mr. FITHIAN. You had more, and you aren't sure?

Mr. HERBERT HUNT. I think so. I would have to go back and check numbers and, of course, we have got to keep in mind that the size of the contract has changed since 1973. It used to be 10,000 ounces to a contract. It is now 5,000 but I would have to go back and look.

Mr. MARLENEE. Would the gentleman yield?

Mr. FITHIAN. I would be happy to since the chairman is not ready to run me down with the gavel.

Mr. MARLENEE. That figure early in 1979, prior to July according to the information I have was 5,393 to some 8,354 contracts, and I think it is a very pertinent question, the argument that you are pursuing here, the number of contracts they did in fact hold in 1973 through 1979, and the size of those contracts as brought out.

Mr. FITHIAN. We are all novices on this side of the board.

Mr. HERBERT HUNT. I feel like one on this side too.

Mr. FITHIAN. But it must be apparent to you that if you use the practice at the rollover time of acquiring more contracts, that you were intending to crowd what you have already described as a short supply situation, that is that the demand was greater than

the supply because of all of the economic factors that you are talking about, you didn't trust the rest of the money markets and so on, and so it does have the tendency, does it not, to drive the price upward, if you take a thousand contracts in 1974 and they become 8,000 contracts in 1979, you surely must—I mean surely I am not that far wrong.

It would tend to crowd the market upward ultimately toward that \$40 range, wouldn't it? I can't imagine anything else.

Mr. HERBERT HUNT. What I am saying is, I think if you go back in years past I have had positions as large or larger than I had in July 1979.

Mr. FITHIAN. But I am taking that whole 6-year period from 1973 to 1979, and if our figures are correct, you increased your position over that whole time frame, and my question is a very naive one.

I suppose it goes without answering, but that does tend to drive the prices of silver upward.

Mr. HERBERT HUNT. The price of silver is going to be responsive to supply and demand.

Mr. FITHIAN. And if you are demanding more the price is going up?

Mr. HERBERT HUNT. I think the whole world was wanting more silver. I don't think it was just the Hunts. I think you would have all kinds of factors in the market. You had Afghanistan in the middle of this thing, the Middle East unrest, the Iranian situation, and all of those things are factors in the market, and have an effect on price.

Mr. FITHIAN. I thank the chairman for his patience.

Mr. HARKIN. Thank you, Mr. Fithian. Mr. Marlenee?

Mr. MARLENEE. I would yield the gentleman from Indiana 2 additional minutes of mine if he so desires to pursue that.

Mr. FITHIAN. I don't know if we are going to get anywhere with this. I just believe that we should not allow the record to stand with the description we have had this morning that the Brothers Hunt actions and the family actions here had nothing or little to do with the overall price of silver during this period of time.

We have had a lot of testimony here, Mr. Chairman, that the overall price of silver being artificially driven up did some serious harm to a lot of investors, did some serious harm to people like Eastman Kodak, did some serious harm to their employees and unemployment in that sector.

This morning we had a German Bundestag member here who told me over breakfast that he simply had literally hundreds of his own constituent employees put to the wall and out of practice simply because of the manipulation of the silver market in the United States.

I mean that is the general story, and we are getting this morning something that is vastly different from that. It is as though some natural forces out there of increasing demand for silver were just naturally causing silver to go up.

That might be true from \$2.50 to \$6 or \$8, I don't know, but it surely can't be true from \$2.55 to \$45. I don't even believe anybody would believe that, and that is why I am a little disturbed at the testimony.

Mr. MARLENEK. Regaining my time, I think the point the gentleman is pursuing is very valid and some of the decisions that we will make in this committee balance on the answers to those questions.

Did you in fact, prior to July 1979 have more contracts—a larger position than you did after July 1979 when we had my figures show 8,300 some contracts—and if you had fact more contracts prior to that time, why didn't the silver market escalate at that time?

Why wasn't there a shortage? Were there other factors that entered in? I wish you would provide us, the committee, with the information as to your position at some time prior when you held an amount or several contracts, and what the total of those contracts was, if you would, please.

Mr. HERBERT HUNT. All right, I will be glad to go back and try to reconstruct that information. It is over a long period of time but I will look at it.

Mr. FITHIAN. Would the gentleman yield 30 seconds?

Mr. MARLENEK. Yes.

Mr. FITHIAN. Wouldn't it be relatively easy, Mr. Chairman, for anybody from the regular company books to know what the year-end position was in total contracts held? How difficult would that be to reconstruct? That would be the kind of information I would think that the committee would need to then go back to the exchanges and say the Hunts' accusation appears to us to be valid, which would be a serious, serious matter for us legislatively.

I would like to ask unanimous consent that the witnesses this morning supply the information to the committee as to the total contracts held at the end of each year from 1973 to 1979.

Mr. HARKIN. Let me ask the witness if that is possible. Do you understand the request made by the gentleman from Indiana?

Mr. HERBERT HUNT. Yes, I understand the request, and I will go back in my records and have them put together the figures.

Mr. GLICKMAN. Reserving the right to object, I assume you want not only the individual accounts but also affiliated accounts, too?

Mr. FITHIAN. Yes. If it is only a partial accounting we could then not confront the exchange with the terribly damaging testimony backed up by whatever evidence they could give us unless we had the indication of how widespread that was.

Mr. HARKIN. Do the witnesses understand what the gentleman from Indiana has requested and will it be possible to fulfill the request?

Mr. HERBERT HUNT. Yes.

Mr. MARLENEK. I appreciate the appearance of the gentlemen before us this morning and thank the chairman for the additional time.

Mr. HARKIN. Mr. Glickman.

Mr. GLICKMAN. I would like to ask Mr. Bunker Hunt another question he referred to before. I asked you about the nature of the futures markets and you indicated that you thought interest was diminished generally in all the futures markets because of the CBOT and Comex action on retroactive higher margin calls.

Do you think that the actions of the CBOT and the Comex had a harmful effect generally on the futures prices and particularly on grain prices?

Mr. NELSON HUNT. Well, I am certainly not an expert on the grains and futures markets in general or grain markets in particular but I was told by the gentleman I was talking to, who I think knew quite a bit about the markets, that the amount of trading had been down extremely drastically in the last 2 and 3 months.

Mr. GLICKMAN. Do you think people are worried that the Congress and CFTC are going to exert more oversight authority, more market surveillance and maybe some people who have been heavily trading in the commodities markets don't want the Fed to know who is doing it and, therefore, they have reduced their trading?

Mr. NELSON HUNT. I don't think that would bother anyone. If you have any appreciable number of contracts you have to send a daily report to the CFTC, so they know every day what your position is. I think that people just—there certainly was a loss of confidence because of the retroactivity of the actions the exchanges have taken.

Mr. GLICKMAN. A separate question. Do you know who a Robert Nahas, N-a-h-a-s, is and what is your relationship with him?

Mr. NELSON HUNT. Yes, I know Robert Nahas. He is a friend of mine.

Mr. GLICKMAN. Is he involved in this silver situation at all?

Mr. NELSON HUNT. I believe he has got some silver, yes, sir.

Mr. GLICKMAN. Was he affiliated with you in any of these—

Mr. NELSON HUNT. I never had any dealings with Nahas in this country at all. I bought some silver from him at one time in London.

Mr. GLICKMAN. How about Mr. Herbert Hunt?

Mr. HERBERT HUNT. I would know him not as well as Bunker. I am not a racehorse fan, so that is how Bunker knows him. I have met him on two or three occasions. But I have had no joint transactions with him on anything of this sort in this country.

Mr. GLICKMAN. Is he Brazilian? Do you know?

Mr. HERBERT HUNT. Yes, I believe he is.

Mr. GLICKMAN. I have read his name being mentioned as a partner of yours in some of the purchases of silver futures or cash silver and I wanted to know if you would comment on that?

Mr. NELSON HUNT. I bought some cash silver with Robert Nahas in London.

Mr. FITHIAN. Would the gentleman yield.

Mr. GLICKMAN. I would be glad to yield.

Mr. FITHIAN. I thank the gentleman for yielding.

I am interested in the cash position you are now describing. My request was rather incomplete when I said the futures position. I intended to include the total position of the Hunts because obviously if they held largely increased amounts of bullion or cash position their futures position would not be the prime element of driving the market upward.

So Mr. Chairman, I would like to request the full position, that is cash and futures, be supplied to us for the end of each year. I would like to amend my request to that.

Mr. HARKIN. Do the witnesses understand again his amended request and will that be possible to supply that information along with his previous request?

Mr. GOLDBERG. I understand his request, Mr. Chairman, with respect to that.

And does the committee also wish to have information concerning the silver bullion holdings of Mr. N. B. and Mr. W. H. Hunt during these periods, that is yearly?

Mr. HARKIN. I believe that is the gentleman's request. The cash as well as the futures.

Mr. FITHIAN. I think it would then give us the kind of data we need.

Mr. GOLDBERG. Our normal practice, sir, has been to ask that the committee staff send us a letter outlining what they would like and we will respond within a reasonable period of time based upon conversations with staff so that we can get the information together. If that is OK?

Mr. HARKIN. Our committee staff will be so instructed to send the request to you in writing for the two items that Mr. Fithian is requesting.

Mr. GLICKMAN. I would close by saying I am appreciative of your testimony here. You have probably seen more of congressional hearing rooms in the last 6 months than many Members of Congress have.

I would tell you that I, myself, have a growing feeling that the futures markets in this country have changed dramatically in the last 15, 20, or 25 years. It is unfortunate for you that you have to be the focus of oversight and legislative concerns over this, but we in Congress have an obligation to the public in general to insure, No. 1, a liquid free market, but No. 2, proper regulatory controls to insure that market is free.

And I want to say I think we have a lot more work to do in the abstract to try to make heads or tails out of what is the effect of the futures industry generally. Are people improperly taking advantage of the public? Does it unnecessarily affect the cash market in the short term more than it should?

These are questions I am sure you have some thoughts on, but I think your testimony today has been quite helpful to us and I appreciate it.

Mr. HERBERT HUNT. Thank you very much.

Mr. NELSON HUNT. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

I believe Mr. Wampler has a question or two.

Mr. WAMPLER. Yes, Mr. Chairman. I don't want to prolong the hearings, the witnesses have been on the witness stand now for something over 2 hours and it is my understanding they may have another appearance today before another committee of the Congress.

In any event, it is my understanding that Senator Proxmire was having hearings perhaps today on legislation that would include, among other things, empowering the Federal Reserve Board to set margins for futures trading on nonagricultural commodities.

Have you had a chance to examine that legislation? Are you familiar with it or do you have a position on it?

Mr. HERBERT HUNT. No; I have not seen it, Mr. Wampler, and I know nothing about it.

Mr. NELSON HUNT. I have not heard anything about it, sir.

Mr. WAMPLER. Well, I think it is obvious from these hearings and from other expressions of concern that have come to the committee that in these general oversight hearings on commodity futures trading, and more especially the role of the Commodity Futures Trading Commission, two things we are going to have to look carefully at.

One is the setting of margins. Where should this function lie? Should it be with the Commodity Futures Trading Commission, should it be with the exchanges or should it perhaps be with the Federal Reserve Board as others have suggested?

And also the thing that concerns me is the role of setting positions in markets, whether we should do that or not.

I read an article from the Tribune of May 2, and here the writer defines manipulation thusly, he says: "A manipulator works the corner by securing a dominant position in the market and then cashes in to take the profit."

Well, I think that is kind of a classical definition, but speaking only for myself, I want to see a viable futures market in this country. I think it serves a very useful purpose, a very useful economic purpose, and if I understand it, in order to have a hedger on one side of the transaction, you must have a speculator on the other, and we must try to keep that within balance, if we possibly can.

I just want to say to both of you again, I appreciate your presence here, and your willingness to answer questions.

And Mr. Chairman, if I may, I would like to close on a somewhat personal question, and ask if either of the Mr. Hunts present here this morning attended Washington & Lee University?

Mr. HERBERT HUNT. I did.

Mr. WAMPLER. Well as a Virginia Tech graduate, one who went to law school at the University of Virginia, I have to say anyone who went to W. & L. can't be all bad.

Mr. HERBERT HUNT. Thank you. I am glad to hear that. When you said you went to Virginia Tech, I thought here comes some old school rivalry.

Mr. WAMPLER. Washington & Lee is one of the great universities in Virginia, Mr. Chairman, and we are very proud of it. And I was under the impression one of the Mr. Hunts attended it and I am glad to know that. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Wampler. I must commend you, because you never fail to get a plug in for the State of Virginia.

Mr. Marlenee, do you have any more questions.

Mr. MARLENEE. No.

Mr. JONES of Tennessee. Does any other member of the subcommittee have questions?

I have two to ask and then we will conclude. I did not take my time. I passed up the opportunity but to either of the Hunts I have a couple questions I would like to ask.

I understand there is a restriction on the so-called Placid loan that prohibits you from taking any position in commodities or any other futures positions for any speculative purpose or otherwise except for the prudent operation of your farm, your ranch, or the sugar business. Is that correct?

Mr. HERBERT HUNT. I don't know whether that is in the Placid loan agreement itself, Mr. Chairman, because as I say, I haven't been involved. I am not an officer of Placid, and I have not read the loan.

But there is an agreement between us—I am talking about Bunker Hunt, myself and Lamar Hunt—in placing the assets in this general partnership arrangement, that we will take no positions, as you categorized them there, on our percentage part.

Now whether that goes on through to the loan agreement or not, I don't know. It may be a provision of the loan agreement.

Mr. JONES of Tennessee. Well, would either of you care to elaborate more on the detail of that restriction as to why you have taken that position? Were you required to do it, in other words?

Mr. HERBERT HUNT. Well, I think that was an agreement between ourselves and Placid Oil Co. in forming the partnership arrangement.

Mr. JONES of Tennessee. Is Placid Oil owned by someone other than the Hunts?

Mr. HERBERT HUNT. No; it is a company owned by a Hunts trust.

Mr. JONES of Tennessee. I see. That is what I thought was true. I thought you said that earlier, too.

Mr. HERBERT HUNT. Yes; I think as a general answer to your question, the answer is probably yes, but I am not sure it is in the loan agreement as such.

Mr. JONES of Tennessee. But it was more or less an agreement on the part of the Hunts to do that? I mean there was no real requirement made of you?

Mr. HERBERT HUNT. That is correct.

Mr. JONES of Tennessee. Can you tell me one other thing about the Placid loan. What is the reason for the exemption for the farm, ranch, and sugar business?

Mr. HERBERT HUNT. Those are—I can't speak for the farming and ranch business, because that is Bunker. The sugar company, obviously they are in the sugar business, and they are, as such, involved in futures markets from time to time, so it is an integral part of the business.

Mr. JONES of Tennessee. Mr. Bunker, would you want to comment?

Mr. NELSON HUNT. Regarding my farming and ranching business, there is a certain amount of hedge selling and it is rather minor, but that is the exemption.

Mr. JONES of Tennessee. Can you speculate in these items or do you just hedge?

Mr. NELSON HUNT. I think just hedge.

Mr. JONES of Tennessee. Just hedge?

Mr. NELSON HUNT. That is right.

Mr. JONES of Tennessee. One final question. Has all or most of your silver been transferred to Placid Oil ownership?

Mr. NELSON HUNT. To the Placid Oil limited partnership, yes.

Mr. JONES of Tennessee. It has been transferred to that ownership?

Mr. NELSON HUNT. Yes; that is right, sir.

Mr. JONES of Tennessee. Does it require that this silver be sold?

Mr. NELSON HUNT. No; as I understand the loan is for 9 years, and it is anticipated the silver will be sold before the 9 years is out.

Mr. JONES of Tennessee. So there is no requirement that the silver be sold by a certain date or that it even be sold? You have a 9 year loan, or 9 year agreement; is that correct?

Mr. NELSON HUNT. That is my understanding.

Mr. HERBERT HUNT. Yes; that is correct.

Mr. JONES of Tennessee. Do the attorneys want to elaborate on that, Mr. Goldberg or Mr. Barry?

Mr. GOLDBERG. Mr. Chairman, the silver interest will be treated as an investment in the partnership and dealt with in an orderly fashion. There is no time limit upon which those silver contracts must be either liquidated or disposed of.

Mr. JONES of Tennessee. But this is a 9-year loan with Placid Oil, is that right? The Placid Oil is a 9-year loan?

Mr. HERBERT HUNT. That is correct.

Mr. JONES of Tennessee. Do any other members have a question?

Gentlemen, that concludes the question period, and I want to ask the subcommittee for unanimous consent that all written requests for witnesses to answer questions will be made a part of the record when such takes place, and any other record that may come forth, that we will put it in, because this does conclude our series of hearings.

I want to thank the witnesses, both Mr. Herbert Hunt and Mr. Nelson Bunker Hunt, for being here, as well as Mr. Amstutz who was here earlier, and we appreciate very much your time and your interest and the courtesy you have extended us.

The committee is adjourned.

Mr. HERBERT HUNT. Thank you, Mr. Chairman.

Mr. NELSON HUNT. Thank you, Mr. Chairman.

[Whereupon, at 1:17 p.m. the subcommittee adjourned.]

[The following additional material was submitted:]

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July 18, 1980

HAND DELIVERED

The Honorable Ed Jones
Chairman, Subcommittee on Conservation and
Credit of the House Agriculture Committee
104 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Jones:

Pursuant to your recent request to Roger Goldberg, Esquire, of the firm of Shank, Irwin, Conant, Williamson & Grevelle, we are forwarding, in our capacity as coordinating counsel, for your information and review the enclosed documents and letters which were previously sent to the Honorable Benjamin S. Rosenthal, Chairman, Subcommittee on Commerce, Consumer and Monetary Affairs of the House Government Operations Committee, and to the Honorable Donald W. Stewart, Chairman, Subcommittee on Agricultural Research and General Legislation of the Senate Agriculture, Nutrition and Forestry Committee.

Very truly yours,

PERITO, DUERK, CARLSON & PINCO, P.C.

Paul L. Perito

Paul L. Perito
Coordinating Counsel

Enclosures

cc: Roger Goldberg, Esquire
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Hon. Benjamin S. Rosenthal
 Chairman
 Commerce, Consumer & Monetary Affairs
 Rayburn House Office Building
 Room B-377
 Washington, D.C. 20515

Dear Mr. Chairman:

This letter is written in response to your letters of May 9, 1980, addressed to our clients, Nelson Bunker Hunt and William Herbert Hunt, in which the Sub-Committee on Commerce, Consumer & Monetary Affairs of the House Government Operations Committee (the "Sub-Committee") requested certain additional information in connection with its inquiry into the operations of the silver futures market.

Our clients have endeavored to respond as fully as possible to the Sub-Committee's requests. It should be noted that much of the information and documents provided have been obtained from Hunt Energy Corporation. For your information, Hunt Energy Corporation is, *inter alia*, a comprehensive service entity that performs services for many corporate entities and individuals, including some of the entities and individuals from whom the Sub-Committee has requested information. Because much of the information was obtained from Hunt Energy Corporation, our clients cannot insure its accuracy, especially with respect to information pertaining to parties other than themselves.

No responses have been provided for Hunt Energy Corporation. We have been informed that Hunt Energy Corporation has no assets, investments, liabilities or involvement which would be responsive to your questions. Further, we have been advised that Hunt International Resources Corporation had no assets,

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investments, liabilities or involvement in the silver or silver futures market during the relevant time period of your inquiry.

You will also note that no information is provided for Profit Investment Company, Inc. Profit Investment Company's sole silver-related investment is its fifty percent (50%) ownership position in International Metals Investment Co., Ltd. Accordingly, information pertinent to Profit Investment Company may be discerned from a review of the data for International Metals Investment Co., Ltd.

Information with respect to Placid Oil Company has been previously submitted to the Sub-Committee under separate cover.

The numbered paragraphs below correspond to the numbered paragraphs in your May 9, 1980 letters. Individuals and entities from whom the Sub-Committee has requested information are listed separately.

I. NELSON BUNKER HUNT

A. Silver Related Assets

<u>A-1</u>	<u>8/1/79</u>	<u>1/1/80</u>	<u>3/28/80</u>	<u>5/2/80</u>
<u>Silver Bullion & Silver Coins (Oz.)</u>				
New York (Chase Manhattan, Citibank, Iron Mountain, Irving Trust, Republic National, Swiss Bank Corp.)	3793100	9610400	15837200	9128500
Chicago (Continental Illinois of Chicago, First National Bank of Chicago, Harris Trust)	17155700	17155700	23577300	7706800
New Jersey (Engelhard Minerals & Chemical Corp.)			5930800	-0-
Arizona (North America Coin & Currency)		862700	-0-	-0-
London (Derby & Co., Samuel Montagu Sharps - Finley, Johnson-Matthey).			8595000	495000
Total Oz.	20948800	27628800	53940300**	17330300

**According to certain reports, Bache Malsey Stuart Shields, Inc. liquidated 10,236,000 ounces of silver as of the close of business on March 28, 1980, thereby reducing this figure accordingly.

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Nelson Bunker Hunt (cont.)

<u>A-2</u>	<u>8/1/79</u>	<u>1/1/80</u>	<u>3/28/80</u>	<u>5/2</u>
<u>Silver Futures Contracts</u>				
Comex:				
March, 1980 - Long	11838	12556		
May, 1980 - Long	150	1150	30	
July, 1980 - Short	(2500)	(775)		
July, 1980 - Long				
Sept., 1980 - Short	(740)	(485)		
Dec., 1980 - Short		(5222)	(1397)	
March, 1981 - Short	(2550)	(308)		
March, 1981 - Long	6158	6916	1003	
			(364)	
CBOT:				
Feb., 1980 - Long	3030	3100		
April, 1980 - Long	500	521		
Dec., 1980 - Short		(271)		
April, 1981 - Short	(500)	(250)		
	<u>3030</u>	<u>3100</u>		
Total Open Positions Comex & CBOT	9228	10016	(364)	

A-3Silver Forward Contracts (Ox.)

<u>London Metal Exchange</u>				
Merrill Lynch				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			444000	
April 25, 1980			140000	
July 21, 1980				584
		<u>650000</u>	<u>584000</u>	<u>584</u>
ACLI International Commodity Services				
May 6, 1980			1100000	1100
May 7, 1980			330000	3300
			<u>1430000</u>	<u>14300</u>
Swiss Bank Corporation-Zurich-Various Dates				
		750000	3158000	3158
Total		<u>1400000</u>	<u>5172000</u>	<u>5172</u>

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Nelson Bunker Hunt (cont.)

<u>A-4</u>	<u>9/1/79</u>	<u>1/1/80</u>	<u>3/28/80</u>	<u>5/2/</u>
<u>Contractual Rights to Purchase Silver</u>				
Naji Robert Nahas (oz. of silver bullion)			1407000	1407
<u>A-5</u>				
<u>Financial Interest - Brokerage Firm</u>				
Rache Halsey Stuart Shields Inc. Shares of Stock (Common)		157600	288350	288
<u>A-6</u>				
<u>Financial Interest-Following Companies*</u>				
Global Marine Inc. (Shares of Stock)	217050	217050	213000	100
IMIC (Non-Convertible Debt)				15000
Profit Investment Co. Shares of Stock (Preferred) Non-Convertible Debt	2500 5500000	2500 5500000	2500 5500000	21 55000

*Nelson Bunker Hunt and Goldfield Corp. entered into an agreement in principle which provided that Nelson Bunker Hunt could purchase a certain number of the shares of Goldfield Corp. for a specified price; further provided that Nelson Bunker Hunt could purchase a 20% interest in a silver mining prospect in New Mexico for a specified price; and granted Nelson Bunker Hunt options for the purchase of an additional 30% interest in the prospect. Mr. Hunt has not exercised any of these rights under the agreement.

A-7

To the best of his knowledge, Nelson Bunker Hunt has no relationship with the National Commodity and Barter Association, Multi-Projects, Ltd., or the American Law Association.

Nelson Banker Hunt (cont.)B. Silver Related Liabilities

<u>B-1</u>	<u>8/1/79</u>	<u>1/1/80</u>	<u>3/28/80</u>	<u>5/2/80</u>	<u>Collateral</u>
<u>Debts - Brokerage Firms (Outstanding Principal Only)</u>					
Silver Bullion Loans					
ACLI International Inc. - N.Y.					
July, 1979	16529800	99731000	39731000		2,796,000 oz. Silver Bullion
Oct. 1979			14064500		3,131,400 oz. Silver Bullion
Jan. 1980			9845000		6,250,400 oz. Silver Bullion
Feb. 1980			30014700		7,133,800 oz. Silver Bullion
March, 1980	16529800	39731000	93655200	51155100	
Barthe Halsey Stuart Metal Co. - N.Y.					
Dec. 1973 - Aug. 1979	32010000	30000000	30000000		
Oct. 1979 -			4630300		
Jan. 1980			186800000		
Feb. 1980	32010000	30000000	221430300*	-0-	4,671,600 oz. Silver Bullion
				-0-	6,362,800 oz. Silver Bullion
				-0-	16,768,800 oz. Silver Bullion
E. F. Hutton - N. Y.					
March 1980			87000000*		6,785,200 oz. Silver Bullion
Mocatta Metals - N. Y.					
Sept. 1976 - March, 1979	24500000	-0-	-0-	-0-	5,182,700 oz. Silver Bullion
Total Silver Bullion Loans	73039800	69731000	402085500	51155100	

*Principal balance prior to liquidation of collateral.

Nelson Bunker Hunt (cont.)

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debits - Brokerage Firms (Cont'd)					
Martin Galls	-0-		6925600		Treasury Bills 19,250,000
Heifold Commodities Inc.	-0-		16049600		"
ACLI International	74400		"		"
Herrill Lynch	125000		"		6250000 oz. Silver Bullion
Bache Halsey Stuart			15456300		"
Prime Webber					"
Clayton Brokerage Co.	925000		8816000		Treasury Bills 6,210,000
Dean Witter Reynolds			5989700		Treasury Bills 1965000
A. G. Edwards			4252200		"
E. F. Hutton			"		"
Shearson, Loeb, Rhoads	1195600		"		"
	2,320000		"		"
Silver Bullion Deliveries			"		"
Bache Halsey Stuart			"		"
Total Debits - Brokerage Firms	75359800	69731000		51155100	
*Information in dispute; non-verifiable at this time.					
B-2					
Debits-Banks (Outstanding Principal Only)					
Citibank, N. A.			25000000	17500000	1739 Bags 90% Silver Coins 659 Bags 40% Silver Coins 10 Bags Silver Dollars
Credit Lyonnais, N. Y.	10081000	15000000	15000000	-0-	1125400 oz. Silver Bullion
J. Henry Schroder Bank & Trust Co., N.Y.	5000000	8000000	9000000	-0-	1478400 oz. Silver Bullion 4954657 oz. Silver Bullion
Swiss Bank Corp., N.Y.	35000000	-0-	166080600	77388800	8506708 oz. Silver Bullion 8250462 oz. Silver Bullion
First National Bank of Chicago	10500000	5000000	35000000	18000000	Various oil & gas leases, stocks, cattle, horses, real property, notes receivable
First National Bank in Dallas			18000000		
Total Debits-Banks	60581000	28000000	202000000	112688800	
*Not all of the listed liabilities are silver-related debts.					

SHANK, IRWIN, CONANT, WILLIAMSON & GREVILLE

B-3

Debts-Other Persons**
 Placid Oil Company

8/1/79

1/1/80

3/28/80

30,000,000

**Hunt Holdings, Inc. (Pented Resources, Inc.) owed \$10,000,000 during period 3/10/80. Also, in connection with an apparent acquisition of silver from Haji Robert Mahas, per credit, a purported obligation to Haji Robert Mahas with respect to that acquisition is dispute.

C. Bank Loans and Lines of Credit

1a. In general, the liabilities discussed at Boca Raton, Florida on March 30, 1980 were those liabilities set forth in response to Question 8 above.

1b. To the best knowledge of our clients, the bank officers, by name and bank affiliation, with whom these liabilities were discussed, were as follows:

Willard Butcher	- Chase Manhattan
Dick Thomas	- First National Bank of Chicago
William Spencer	- Citibank
Louis Prestige	- Morgan Guaranty
Bob Stuart, Elvin Mason	- First National Bank in Dallas
Mr. McGillicuddy	- Manufacturers Hanover Trust
W. T. Hundt	- Swiss Bank Corporation
	- Bank of America
	- Chemical Bank
	- Continental Illinois of Chicago

2. Attached hereto is a copy of an Agreement of Limited Partnership of Placid Investments, Ltd. among Placid Investment Company, as General Partner and Nelson Bunker Hunt, William Herbert Hunt and Lamar Hunt, as Limited Partners. This Agreement is responsive to your questions with respect to the partnership.

3. Attached hereto is a copy of the Revolving Credit Agreement among Placid Oil Company as Borrower, First National Bank in Dallas and Morgan Guaranty Trust Company of New York as Agents and Thirteen Banks as Lenders. This document is responsive to your questions with respect to the loan arrangements.

II. WILLIAM HERBERT HUNT

A. Silver Related Assets

A-1

8/1/79

1/1/80

3/28/80

Silver Bullion & Silver Coins (Oz.)

New York	4483400	4483400	9645500
Chicago	16664000	16623200	22873100
New Jersey			2570000
Arizona		862700	
London			1450000
Total Oz.	20947400	21969300	36538600

SHANK, RUTH, COMANT, WILLIAMSON & GREVELLE

William Herbert Hunt (cont.)

A-2	8/1/79	1/1/80	3/28/80	5/1/80
<u>Silver Futures Contracts</u>				
Comex:				
Sept. 1979 - Long	115			
Dec. 1979 - Long	250			
Jan. 1980 - Long	380	250		
March 1980 - Long	330	847		
May 1980 - Long	7114	7379	1203	
July 1980 - Short	(4544)	(4424)	(1846)	
Sept. 1980 - Long		33	25	
March 1981 - Long			336	
May 1981 - Long				
July 1981 - Long				
	3445	3885	(349)	
CBOT:				
Oct. 1979 - Long	31			
Dec. 1979 - Long	49			
Feb. 1980 - Long	2266	2266		
April 1980 - Short	(1420)	(1360)	(507)	
Dec. 1980 - Long		49	49	
Feb. 1981 - Long				
	926	955	(458)	
Total Open Positions - Comex & CBOT	4391	4840	(707)	

A-3Silver Forward Contracts (Oz.)

<u>London Metal Exchange</u>				
Merrill Lynch:				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			443000	
April 25, 1980			140000	
July 21, 1980				58
		650000	583000	58
ACLI International Commodity Services				
May 6, 1980			330000	336
Swiss Bank Corporation - Zurich-Various Dates	-0-	750000	3150000	3156
Total	-0-	1400000	4071000	4071

SHAW, IRWIN, CONANT, WILLIAMSON & GREVELLE

William Herbert Hunt (cont.)

A-4	8/1/79	1/1/80	3/28/89	5/2/80
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Contractual Rights to Purchase Silver

Naji Robert Nahas (no. of silver bullion)			845000	845000
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A-5Financial Interest-Brokerage Firms

Bache Halasy Stuart Shields Inc. (Common)				
Shares of Stock	157600	288250	288250	

A-6Financial Interest-Following Companies

Global Marine Inc.				
Shares of Stock (Common)	217050	217050	213000	100650
Profit Investment Co.				
Shares of Stock (Preferred)	2500	2500	2500	2500
Debt Investments (Non-Convertible)	5500000	3300000	5500000	5500000

A-7

To the best of his knowledge, William Herbert Hunt has no relationship with the National Commodity and Barter Association, Multi-Projects Ltd., or the American Law Association.

B-1 Debits - Brokerage Firms (Outstanding Principal Only)	B. Silver Related Liabilities			
	8/1/79	1/1/80	3/28/80	5/2/80
Silver Bullion Loans				
ACLI International Inc. - N.Y.				
July, 1976 - Aug. 1979	13309200	26559800	26559800	
October, 1979			10000000	
Feb., 1980			4043000	
March, 1980	13309200	26559800	40602300	38107800
				2251300 Oz. Silver Bullion
				3142300 Oz. Silver Bullion
				3881000 Oz. Silver Bullion
Bache Walsey Stuart Metal Co. - N.Y.				
Dec. 1973 - Aug. 1979	3199700	7000000	7000000	
October, 1979			5000000	
Feb. 1980	3199700	7000000	12000000**	-0-
				580900 Oz. Silver Bullion
				4128900 Oz. Silver Bullion
Clayton Brokerage Co. - St. Louis				
October, 1976 - Aug. 1979	37306900	-0-	-0-	5724700 Oz. Silver Bullion
E. F. Button - N.Y.				
March, 1980			13000000**	-0-
				2058700 Oz. Silver Bullion
Merrill Lynch - N.Y.				
January, 1980			26000000	
March, 1980			76501200	
			102501200	8219600 Oz. Silver Bullion
Moretta Metals				
Sept., 1976 - March, 1979	25900000	-0-	-0-	5529100 Oz. Silver Bullion
Total	79715800	168104000	16810400	113880500

**Principal balance prior to liquidation of collateral.

	8/1/79	3/28/80	5/2/80	Collateral
William Herbert Hunt (cont.)				
Silver Related Liabilities				
B-1				
Debits - Brokerage Firms (Cont'd)				
Morgan Falls				
Herrill Lynch				
Bache Malsey Stuart				
Paine Webber				
Cargill Investor Services				
ACLI International				
Doran Witter Reynolds				
Clayton				
Total	57100	12237000		316600 oz. Silver Bullion *
	57100	19194000		
	79772900	37129000	4070300	Treasury Bills 7,900,000
Total Debts - Brokerage Firms		8348900		
* Information in dispute; non-verifiable at this time.		24218400		
		192327400	117950700	
B-2				
Debits - Banks (Outstanding Principal Only)				
Citicbank, N. A. - N.Y.				
		25000000	17500000	1739 Bags 90% Silver Coins 659 Bags 40% Silver Coins 10 Bags Silver Bullion
Credit Lyonnais - N.Y.			-0-	1300400 oz. Silver Bullion
Swiss Bank Corp. - N.Y.	35000000	15000000		1043300 oz. Silver Bullion
		100000000		6483100 oz. Silver Bullion
				10112600 oz. Silver Bullion
				89468000 9538170 oz. Silver Bullion
First National Bank in Dallas		2000000	2000000	Oil, Gas & coal leases, stocks, real property, notes receivable
			-0-	
First National Bank of Chicago	19500000	15000000		
Total Debts - Banks	54500000	157003000	108968000	
B-3				
Debts - Other Persons (Outstanding Principal Only) **				
Nelson Bunker Hunt		40500000	50000000	
Placid Oil Company		55000000	135088400	
		95500000	185088400	
Total Debts - Others				
** Hunt Holdings, Inc. (Pentac Resources, Inc.) owed \$10,000,000 from period 3/10/80-3/26/80. Also, in connection with an apparent acquisition of silver from Majl Robert Nahas, partially on credit, a purported obligation to Majl Robert Nahas with respect to that acquisition is in dispute.				

estment Holdings, Inc. (Pentac Resources, Inc.) used \$10,000,000 from period 3/10/80-3/26/80. Also, in connection with an apparent acquisition of silver from Naji Robert Nhas, partially on credit, a purported obligation to Naji Robert Nhas with respect to that acquisition is in dispute.

SHANK IRWIN CORANT WILLIAMSON & GREVILLE

William Herbert Hunt (cont.)C. Bank Loans and Lines of Credit

See responses of Nelson Bunker Hunt.

III. INTERNATIONAL METALS INVESTMENT CO., LTD.A. Silver Related Assets

<u>A-1</u> <u>Silver Bullion & Silver Coins</u>	<u>8/1/79</u>	<u>3/1/80</u>	<u>3/28/80</u>	<u>5/2/80</u>
New York		5643000	4625000	4170000
Chicago		4804000	4203000	4203000
Various U. S. Banks		7537000	7537000	7537000
London		18030000	6164000	6164000
Zurich		8991000	9496000	7061000
		<u>3700500</u>	<u>53825000</u>	<u>29135000</u>

<u>A-2</u> <u>Silver Futures Contracts</u>				
<u>Comex:</u>				
Sept., 1979 - Long	30			
Dec., 1979 - Long	261			
May, 1980 - Long		881	367	
July, 1980 - Long	200	1000	727	
		<u>135</u>	<u>135</u>	105
Sept., 1980 - Long	<u>511</u>	<u>2016</u>	<u>1229</u>	<u>105</u>

<u>CBOT:</u>				
Oct., 1979 - Long	75			
Dec., 1979 - Long	296			
April, 1980 - Long		576	431	
June, 1980 - Long	200	990	990	146
Aug., 1980 - Long		<u>226</u>	<u>226</u>	<u>226</u>
	<u>571</u>	<u>1792</u>	<u>1647</u>	<u>372</u>

Total Open Positions - Comex and CBOT	1082	3808	2676	477
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A-3
Silver Forward Contracts (On)

<u>London Metal Exchange</u>				
Merrill Lynch				
March 11, 1980	600000			
March 18, 1980	50000			
April 22, 1980		443000		
April 23, 1980		<u>140000</u>		
	<u>650000</u>	<u>583000</u>		

SHAW, IRWIN, CONANT, WILLIAMSON & GREVILLE

International Metals Investment Co. Ltd. (cont.)

	<u>8/2/79</u>	<u>1/1/80</u>	<u>3/28/80</u>	<u>5/2/80</u>
ACLI International Commodity Services May 6, 1980			330000	
Swiss Bank Corporation-Zurich				
May 14, 1980			333000	333000
May 19, 1980			117000	117000
June 3, 1980			83000	83000
			533000	533000
Mocatta Metals Corporation - New York				
Jan. 4, 1980	160000			
Jan. 21, 1980	70000			
Jan. 31, 1980	150000			
Feb. 4, 1980	85000			
Feb. 29, 1980	150000			
Mar. 3, 1980	65000			
Mar. 31, 1980	150000	150000		
April 1, 1980	40000	40000		
April 30, 1980	150000	150000		
May 5 through Dec. 31, 1980	4178000	4178000	4178000	4178000
	<u>5178000</u>	<u>4578000</u>	<u>4578000</u>	<u>4578000</u>
	5828000	5964000	4711000	

International Metals Investment Co., Ltd. (cont.)

B. Silver Related Liabilities

B-1	Debits - Brokerage Related (Outstanding Principal Only)	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
		-0-	50000000	287750000	199529000	
	Merrill Lynch					4,590,000 oz. Silver Bullion, 146,100,000 oz. Silver Bullion; Coins; 3200 oz. Gold; Treasury Bills of 166,000,000 13,080,000 oz. Silver Bullion; Coins; 3200 oz. Gold; Treasury Bills of 44,000,000
B-2	Bank Debt-Silver Related (Outstanding Principal Only)					
		8/1/79	1/1/80	3/28/80	5/2/80	
	Schroder Bank-Zurich		10000000	20000000	20000000	2,367,400 oz. Silver Bullion
	Bank Arab International Inc.-Paris			10000000	10000000	1,435,500 oz. Silver Bullion
	Saudi Finance Corporation-Paris			26000000		2,468,500 oz. Silver Bullion
	Bank Leu-Zurich			50000000	21401000	2,783,750 oz. Silver Bullion
	Citibank-New York		25000000	40000000	40000000	2,580,000 oz. Silver Bullion
	Swiss Bank Corporation		150000000			3,185,000 oz. Silver Bullion
	First National Bank-Dallas		185000000	15000000	91401000	Guaranteed by N. B. Hunt
				161000000		
B-3	Other Debts-Silver Related (Outstanding Principal Only)					
		8/1/79	1/1/80	3/28/80	5/2/80	
	Mocatta Metals Corporation		25482060	17677000	13855550	Silver Forwards Contracts
	Various U.S. Banks on Coin Options		12003000	12003000	12003000	Silver Coins
	N. B. Hunt			20000000	15000000	
	Subordinated Loans from Shareholders	20000000	20000000	49680000	60858550	
		20000000	57485060			

SHANK, IRWIN, COHANT, WILLIAMSON & GREVELLE

IV. IRVING INTERNATIONAL MINERALS LTD.

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Silver Bullion (Oz.)					
New York	504900	504900	504900	-0-	

A-2

Silver Futures Contracts

Comex:					
May 1980	54	54	-0-	-0-	

B. Silver Related Liabilities

B-1

Debts - Brokerage Firms (Outstanding Principal Only)

Silver Bullion Loans

Rache Halsey Stuart Metal Co., March 1975-Aug. 1979	2759300	2759300	-0-	-0-	504900 Oz. Silver Bullion
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Margin Calls

Rache Halsey Stuart
Shields, N.Y.

Total Debts - Brokerage Firms	2759300	2759300	0	-0-	
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*Information in dispute; non-verifiable at this time.

V. PLANET INVESTMENT CORPORATION

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/26/80	5/2/80
Silver Bullion (oz.)				
Swiss Bank Corporation	3,000,000	3,000,000	3,000,000	
First of Chicago, Continental				3,003,359.19
Illinois Bank				

SHARP, IRWIN, CORANT, WILLIAMSON & GREVILLE

Planet Investment Corp. (cont.)B. Silver Related Liabilities

Planet Investment Corporation has a non-silver related obligation to Manufacturers Hanover Trust Company which is secured by substantially all of its assets, including the 3,000,000 ounces of silver bullion, and such obligation is further guaranteed by N. B. Hunt and W. H. Hunt.

The foregoing information submitted to you on behalf of our clients is based upon their best knowledge and information available to them at this time. While our clients believe that the information set forth in this letter is accurate, they nevertheless cannot at this time confirm or insure either its accuracy or completeness. This is so because:

- (a) the information was compiled from data secured primarily from third parties;
- (b) the information was gathered by persons other than our clients, and
- (c) the time frame within which the information was gathered was limited.

The foregoing information, together with copies of the agreements attached hereto, should satisfy the questions raised in your May 9, 1980 letters. Please consider this information as confidential and intended solely for the purposes and use of your Sub-Committee.

Respectfully submitted,

Roger Goldburg
Roger Goldburg

RG:hm

cc: W. B. Hunt
W. H. Hunt

By THOMAS A. BLANCH

Let it be noted, however, that Germany's rail-mounted rail, as the most likely to become the standard

over its commodity market reputation as it is given economic stimulus, such as the very large portion committed by the State and others to the silver market? The most obvious suggestion is to put control of foreign requirements in the hands of a Federal agency, rather than leaving it with the commodity exchanges. After all, some could be obtained on the

Japanese government has to tell people from themselves, if they worry that the trading is dangerous, we can be tolerant to their freedom. However, the market have not demonstrated the readiness to do it. unless it passes price cap, it should not pass a working free market system by imposing government controlling measures.

But to equate maintenance charges with excessive charges is to disregard what the rate charges really are in the construction industry. On that, the chairman of the House's proposed panel is at least in line, by fellow construction industry members.

In the competitive market, enough resources & development for complete purchase on credit. In the competitive

Thomas A. Ryan, a partner at Godwin, Procter & Gore, is a former director of the C.P.T.C.'s Board of trustees and members.

June 5, 1980

TELEVISION STATIONS
 JAMES W. HARRIS, JR.
 JAMES D. GIBBY, JR.
 J. WILLIAM STEVENS, JR.
 WILLIAM S. STEPHENSON, JR.
 THE LEE GROUP, INC.
 SAM BRITTE, JR.
 G. W. HARRIS, JR.
 JOHN RUFF, JR.
 LYLE WILLIAMS, JR.
 JAMES J. BRIDGES, JR.
 CHARLES N. STEPHENSON, JR.
 DR. STEPHEN, JR.
 ARLEN STEPHEN, JR.
 GEORGE A. STEPHEN, JR.
 JOHN STEPHEN, JR.

THEATRE STATIONS
 THEATRE STATIONS, INC.
 THEATRE STATIONS, INC.

TELEVISION STATIONS
 TELEVISION STATIONS, INC.
 TELEVISION STATIONS, INC.

Dear Mr. Chairman:

It may be possible to trace the recent problems in futures markets to the lack of an internally consistent, general regulatory approach on the part of the CFTC. In its infant years, the CFTC has not yet developed a consistent overall regulatory package and has too frequently taken a piecemeal, ad hoc, approach to the regulation of futures markets.

Excess speculation is of concern because it can result in futures prices deviating from cash prices. Much of the current debate about federal regulation of margin, or other methods of controlling "excess speculation" address symptoms rather than the underlying question of the standards and criteria used by the CFTC in designing contract markets. When the Commodity Exchange Act was amended in 1974 a new subsection (g) was added to Section 5 of the Act (Public Law 93-463, § 207) requiring a board of trade, before designation, to demonstrate that the contract would be used by producers, merchants or consumers as a means of hedging themselves against possible loss resulting from fluctuations in price. I do not believe futures contracts which attract very little hedging participation and are used principally for speculation meet the intent of the law or are in the public interest. Clearly, something more than occasional use of the contract for hedging should be necessary before a contract can gain and maintain designation.

The Honorable Ed Jones
Page 2

Chairman Stone, in his testimony before your Subcommittee on May 21, 1980, stated that less than 20% of the open interest in frozen pork bellies, Treasury securities and silver futures contracts represent commercial hedging activities. The attached table identifies hedging participation in the contract markets reported by the CFTC and shows other markets which attract small hedging participation. These data reflect a sorry situation, not only in those commodities listed by Stone, but also in hogs, cattle, lumber and plywood. We must remember these data are based on the gross hedging definition which allows speculation under the guise of double hedging. Also, the hedging data are derived from large trader reports filed with the CFTC. The CFTC does not review the classification of positions as hedging or speculative on any re-occurring basis and in commodities in which the CFTC does not have speculative limits, it makes no effort to verify the accuracy of data submitted by traders. Thus, the CFTC hedging data are of questionable accuracy, and most assuredly overstate the true amount of bona fide hedging against net cash price risk, which means the true picture is even worse than the data indicate.

On page 76, of the House Report on the 1974 amendments, Dr. Clayton Yeutter called for further clarification of the "economic purpose" test for designation of futures contracts and stated that: "We do not believe that this (test) sets forth an adequate guideline. Trading in almost any futures contract may serve a price basing purpose but may still be designed primarily for gambling purposes and have no real economic value other than to the individual participants." Although I believe the intent of Congress was clear enough, the Commission has had resource problems and met resistance which sapped some of the agency's needed resources in this exploding industry. Therefore, it would be advantageous both in terms of time and effectiveness to legislatively provide the "further clarification" which Dr. Yeutter requested.

I believe there should be an economic purpose test which is specifically keyed to a minimum amount of hedging. For a contract to gain and maintain CFTC designation, it should be required that bona fide hedging transactions make up some minimum percent of the trading volume. If the minimum were set, for example, at 30 percent, then new contracts which cannot be expected to attract substantial hedging participation would not be designated and existing contracts which become dominated by speculative trading would be subject to losing their contract market designation unless the Commission is convinced that the situation will be cured in the near future.

The Honorable Ed Jones
Page 3

Once a meaningful economic purpose test is specified by Congress, the remainder of a consistent regulatory package becomes readily apparent. This would include the following CFTC (or, if necessary, Congressional) actions:

1. Redefine bona fide hedging on a net cash basis, rather than on a gross basis as is currently done. The effect of gross hedging is to permit traders with substantial cash purchase and sales commitments to speculate far in excess of the applicable speculative limits. A net definition should specify that a futures hedge position must be opposite the net cash position and cannot exceed the amount of the net cash position by more than the speculative limit. This would allow hedgers flexibility in their hedge positions; preclude the practice of double hedging; and insure that all traders' speculative impact be constrained by the speculative limits.

2. Place speculative limits on all futures contracts. The size of these limits would logically be a function of the amount of hedging (consistent with the economic purpose test mentioned above) and number of potential traders.

3. Establish proper data gathering to enforce the net hedging definition and speculative limits. The CFTC currently has the authority to and should be collecting detailed (fixed and unfixed price) cash sales and purchase data from all large traders classified as hedgers. Such data could and should be of enough detail to separate domestic sales from export sales contracts by country of destination, and include repurchase agreements. The aggregate of such detailed data should then be reported to the public within a specified time of its collection (for example, 24 hours), consistent with Section 8(a) of the CEA Act (7 U.S.C. § 12 (a)). Since only those who hold positions in excess of reporting levels would be involved, the number of traders required to report would not be great.

Also, it is my view that margins in futures markets should only be used to insure the financial integrity of contracts and, given the above approach, not be used to try to control the problem of excess speculation. Margins are not an appropriate tool to deal with excess speculation.

The major problem with Exchanges setting margins is that members of the board which decides the levels of margins also can have significant positions in the futures for which margins are being set. Although the Exchanges offered testimony which indicates that, as a matter of practice, members of the board abstain from voting on matters in which they have a financial interest, it is not entirely clear whether members with a financial interest in the matter being discussed, do in fact limit their participation in

The Honorable Ed Jones
Page 4

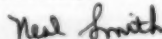
board decisions. Exchange rules do not require abstention nor do they limit the participation in board meetings or the subtle influences by members having a financial interest in the board's action.

I would suggest, as recommended in the 1974 Report of the Small Business Subcommittee on Special Business Problems (H. Rep. 93-963, pp. 17-21), that the CFTC exercise close oversight over the Exchange boards which set margins and have the authority to disapprove any margin changes. I would also suggest that the CFTC not designate a contract market and have authority to revoke such contract market designation if Exchange rules are not sufficient to protect against an abuse of discretion or any appearance of a conflict of interest by board members having a financial interest. Appropriate rules should, at a minimum, provide that a significant majority of board members must not have a financial interest in any action taken by the board; require immediate public disclosure of the vote of each board member; and require public disclosure of the net long or short position of any member having a position in the market. With appropriate Exchange rules, and with the CFTC diligently exercising its authority to review or disapprove any changes, Exchanges should continue to set margins.

Although, I believe the CFTC needs more resources, especially computerized position information, it is my view that unless the CFTC also faces its regulatory responsibilities by developing a consistent package such as the one outlined above, it will continue to be plagued by problems caused by excess speculation for years to come. I believe the above proposals are the most appropriate way to address the problems considered in your recent hearings.

With best wishes, I am

Sincerely,



Neal Smith
Member of Congress

NS:jwhcs
Enclosure

cc: Chairman James M. Stone
Commissioner Read P. Dunn, Jr.
Commissioner David G. Gartner
Commissioner Robert L. Martin

TABLE

Futures

% of Open Interest Held by Either
Long (L) or Short (S) Large Hedgers
as of April 30, 1980 *

Wheat (KCBT)	84.68 (L)
Wheat (MGE)	76.5 (S)
Wheat (MCE)	16.3 (L)
Wheat (CBT)	53.5 (L)
Corn (CBT)	59.3 (L)
Corn (MCE)	**
Oats (CBT)	42.3 (S)
Soybeans (CBT)	56.9 (L)
Soybeans (MCE)	**
Soybean Oil (CBT)	54.4 (S)
Soybean Meal (CBT)	65.8 (S)
Live Hogs (CME)	6.2 (L)
Live Hogs (MCE)	22.6 (S)
Pork Bellies (CME)	10.5 (S)
Live Cattle (CME)	27.3 (S)
Feeder Cattle (CME)	29.5 (L)
Live Cattle (MCE)	**
Iced Broilers (CBT)	33.3 (L&S)
Fresh-Frozen Broilers (CME)	47.8 (L)
Lumber (CME)	17.7 (S)
Stud Lumber (CME)	31.9 (L)
Plywood (CBOT)	36.0 (S)
Long Term Treasury Bonds (CBOT)	28.2 (S)
Treasury Bonds (ACE)	**
90 Day Paper (CBOT)	20.2 (L)
90 Day Treasuries (IMM)	37.4 (S)
1 Year Treasuries (IMM)	27.9 (L)
3 Month Treasuries (CEI)	36.8 (S)
GNMA (CBOT)	32.4 (S)
GNMA, CD (CBOT)	66.0 (S)
GNMA, CD (ACE)	94.4 (S)
GNMA (CEI)	44.7 (S)
4-6 Year Treasuries (CBOT)	28.0 (S)
Canadian Dollar (IMM)	56.8 (S)
Swiss Franc (IMM)	65.5 (S)
German Mark (IMM)	40.1 (S)
Mexican Peso (IMM)	68.6 (S)
British Pound (IMM)	58.7 (S)
Japanese Yen (IMM)	42.9 (S)
No. 2 Cotton (NYCE)	51.5 (S)
F.C.O.J. (NYCE)	55.9 (L)
Potatoes (NYME)	63.3 (S)
Imported Beef (NYME)	42.0 (L)
Cocoa Old (CSCE)	42.9 (L)
Cocoa New (CSCE)	73.4 (S)
Coffee C (CSCE)	37.3 (S)
Sugar No. 11 (CSCE)	61.6 (S)
Sugar No. 12 (CSCE)	84.9 (L)
Platinum (NYME)	33.7 (S)
Palladium (NYME)	68.0 (S)
U.S. Silver Coins (NYME)	63.9 (S)

* Source: CFTC, Commitment of Traders. Large Hedgers are traders who hold positions in excess of CFTC minimum reporting requirements.

** Less than .05 percent

American Farm Bureau Federation



WASHINGTON OFFICE
425 15TH STREET, N.W.
WASHINGTON, D.C. 20004
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CABLE ADDRESS: AMFARMBU

May 23, 1980

Honorable Ed Jones, Chairman
Subcommittee on Conservation and Credit
Committee on Agriculture
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Jones:

The American Farm Bureau Federation, the nation's largest general farm organization with more than 3.2 million member families, wishes to comment on the Commodity Exchange Act and the activities of the Commodity Futures Trading Commission. Farm Bureau members produce virtually every commodity grown in the U.S., and recognize the importance of an orderly futures market as a means of transferring certain types of financial risk.

Futures trading serves a useful purpose for a number of commodities and should be provided for additional commodities, including rice and cottonseed, where need exists and research shows that futures trading would be beneficial.

Farm Bureau Policy, adopted by the voting delegates to the most recent annual meeting in January, 1980, specifies a number of recommendations concerning futures trading and the Commodity Futures Trading Commission:

- 1) We urge that regulatory laws be strictly enforced;
- 2) We seek additional agricultural representation on the Commodity Futures Trading Commission and other regulatory commissions affecting agriculture;
- 3) We oppose efforts by the CFTC to regulate cash grain;
- 4) We request that oversight hearings be held by the appropriate Committee of Congress to see if the interests of agricultural producers are being harmed by actions of the CFTC in regulating grain markets.

Farm Bureau recognizes that market problems with the March, 1979 wheat futures contract and the more recent market disruption in the trading of silver futures indicate that a review of the CFTC and the futures markets may be of benefit. We commend you for scheduling hearings on this issue.

We believe, however, that further regulatory authority by the CFTC and other agencies is unnecessary and that additional controls would interfere in an effective marketing system.

We request this letter be made a part of the hearing record.

Sincerely,

Vernie Glasen, Director
National Affairs Division



Minneapolis Grain Exchange

May 19, 1980

180 GRAIN EXCHANGE BUILDING MINNEAPOLIS, MINNESOTA 55415
TELEPHONE: (612) 338-6212

FOR THE RECORD

The Honorable Edward Jones, Chairman
House Agricultural Subcommittee on
Conservation and Credit
1301 Longworth Building
Washington, D. C. 20513

Re: H. R. 7183

Dear Chairman Jones:

The Minneapolis Grain Exchange ("Exchange") respectfully requests permission to file this statement on proposed legislation concerning the control of commodity margins. The Exchange regrets that it is unable to attend the scheduled hearings on the proposed legislation, but wanted the House Agricultural Subcommittee on Conservation and Credit ("Committee") to be advised that it is unalterably opposed to any legislation that would transfer control of commodity margins from the commodity exchanges to another entity.

In recent years, there have been several studies conducted on commodity margins and who should control them. The Congress has considered this question several times and has always concluded that the best interests of the public are served by having margins under the control of the exchanges, where fast action can be taken by people fully familiar with all factors affecting a specific commodity.

We believe that proposed legislation to transfer control from the exchanges is due in part to confusion over the reason for margins in commodity trading and the use of margins in securities trading. The term "margin" in commodities is very much different from "margin" in the securities industry. In the securities industry, margin money is lent to a buyer of securities. In commodities, on the other hand, margin is collected from both buyer and seller in equal amounts and deposited with the clearing house in an escrow account. This margin is not a down payment of any kind; it is monies deposited to ensure performance by both parties under the terms and conditions specified in the contract.

The Honorable Edward Jones, Chairman
May 19, 1980
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The Exchanges, over the years, have set margins at levels that strike a very delicate balance. Since the goal of commodity margins is guaranteeing performance, margin levels must be high enough to discourage default, but must not be excessively high, thereby discouraging and/or denying the benefits of the market to those who may need it the most. In times of unusual price movements the exchanges have been able to quickly revise margin rates up or down as necessary to meet these conditions. While in hindsight an exchange may be subject to criticism in a particular situation, this should not detract from the fine job the exchanges have done over the year by being "on the spot" in properly controlling margins, thereby facilitating the efficient marketing of commodities.

We firmly believe that once the purpose of commodity margins is understood, the Committee will agree that no change in the jurisdiction over margins is needed and indeed any change could be very detrimental to the utilization of the futures markets in effectively marketing commodities.

Thank you for your kind consideration of our position.

Very truly yours,

MINNEAPOLIS GRAIN EXCHANGE

W. Dustin Mirick

W. Dustin Mirick
Assistant Secretary

WDM/af

96TH CONGRESS
2D SESSION

H. R. 7183

To provide the Commodity Futures Trading Commission with standby authority to set margin requirements on the trading in commodities.

IN THE HOUSE OF REPRESENTATIVES

APRIL 29, 1980

Mr. GLICKMAN introduced the following bill; which was referred to the Committee on Agriculture

A BILL

To provide the Commodity Futures Trading Commission with standby authority to set margin requirements on the trading in commodities.

- 1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That section 8a of the Commodity Exchange Act is amended
4 by redesignating clause (9) as clause (10) and adding a new
5 clause (9) as follows:
6 “(9) to direct the contract market to set margin require-
7 ments for the trading and clearing of any contract for future
8 delivery of a commodity executed or to be executed on, or

1 subject to the rules of, the contract market at such level, in
2 such manner, and for such period as the Commission shall
3 specify, whenever the Commission has reason to believe that
4 (A) the amount of deliverable supplies, (B) the number of
5 open contracts, (C) the relative size of individual trader's po-
6 sitions, (D) the amount and direction of price movements in
7 the cash or futures markets, or (E) the financial integrity of
8 the market makes such action necessary or appropriate in
9 order to protect persons producing, handling, processing or
10 consuming any commodity traded for future delivery on such
11 contract market, or the product or byproduct thereof, or to
12 protect traders or to insure fair dealing in commodities traded
13 for future delivery on such contract market; and".

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